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# Belt and Road Initiative Tax Journal

## ENHANCING TAX ADMINISTRATION CAPACITY BUILDING: BRITACOM PERSPECTIVE

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**Belt and Road Initiative Tax Journal "一带一路"税收**
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# Looking Back and Into the Future of the Belt and Road Initiative Tax Administration Capacity Enhancement Group

The Belt and Road Initiative Tax Administration Capacity Enhancement Group

As an important platform to implement the initiative proposed by President Xi Jinping of the People's Republic of China of building a community with a shared future for mankind, the Belt and Road Initiative (BRI) is increasingly becoming "a belt of prosperity" and "a path towards happiness" that benefits the world and its people and injects confidence of development into the international community. Under this framework, the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITA-

COM) has been launched in the watertown of Wuzhen, China on 18 April 2019. Around the shared concerns of tax administrations of the BRI jurisdictions, the BRITACOM has been working to strengthen exchanges and mutual learning among all stakeholders and promote the full sharing of best practices and lessons learned. By reinforcing cooperation on tax administration and enhancing tax administration capacity, the BRITACOM has played an instrumental role in advancing the modernization of the tax governance system and governance capabilities of the BRI jurisdictions and made positive contributions to their high-quality economic development.

The Belt and Road Initiative Tax Administration Capacity Enhancement Group (BRITACEG) is a pivotal component of the BRITACOM. The establishment of the BRITACEG represents one of the significant outcomes of the 1st Belt and Road Initiative Tax Administration Cooperation Forum (BRITACOF). It aims to develop itself into an effective platform for tax administrations, international organizations, businesses, and academia involved in the pursuit of the BRI to learn from each other, share knowledge and build up capacity.

## 1. Functions of the BRITACEG

BRITACOM Council Member Tax Administrations and Observers, in accordance with the *Memorandum of Understanding on the Establishment of the Belt and Road Initiative Tax Administration Cooperation Mechanism* (hereinafter referred to as "MoU"), could join the BRITACEG on a voluntary basis in consideration of their jurisdictional conditions. The BRITACEG members, by a set of unified principles and standards and via designated tax training institutes, engage in the provision of tax training programs and technical assistance, development of knowledge products, and discussion on certain tax topics. By doing so, the BRITACEG is able to help tax authorities improve tax administration capacity, enhance cooperation on tax administration, and contribute to the building of a growth-friendly tax environment in BRI jurisdictions. To date, the BRITACEG boasts 20 member tax administrations, and 14 partners comprised of tax administrations, international organizations, and academic institutions.

As Mr. Wang Jun, Commissioner of the State Taxation Administration of China (STA) and Chair of the 1st BRITACOM Council, noted in his closing speech for the 1st BRITACOF, the establishment of the BRITACEG, on the one hand, can pool wisdom and strength to improve tax administration capacity of all parties, on the other hand, can tease out insights and produce good examples in tax administration for participants' reference.

## 2. Performance of the BRITACEG

### 2.1 Overview

Since its inception, the BRITACOM has been working steadily to strengthen partnerships, cooperation, and friendships with all parties involved through a wide range of exchange and training activities. In 2019, as the training provider within the framework of BRITACOM, the BRITACEG held 13 offline training sessions that benefited nearly 350 tax officials from more than 60 jurisdictions. In the same year, four Belt and Road Initiative Tax Academies (BRITAs) were set up successively in Yangzhou and Beijing China, Nur-Sultan Kazakhstan, and Macao SAR, China.

In response to COVID-19, the BRITACEG has held over 20 online training events via its self-developed BRITA website since 2020. Fully leveraging the role of a web-based training platform, these training events received nearly 2,000 tax officials from more than 100 jurisdictions virtually. By conducting tax training, running seminars, and developing knowledge products, among others, the BRITACEG has been working to step up communication and cooperation with other international organizations and professional institutions. To give better play to the role of tax in the joint pursuit of the BRI, the BRITACEG has made consistent efforts to enhance tax administration capacity and promote the sustained improvement of the tax environment in BRI jurisdictions. All these efforts have gained the BRITACEG interna-

tionalprestige in the terrain of tax training.

In accordance with the MoU and the principle of achieving shared growth through consultation and collaboration, the BRITACEG compiled the *Detailed Rules of the Belt and Road Initiative Tax Administration Capacity Enhancement Group (draft version)* and the *Regulations of the Belt and Road Initiative Tax Academies (draft version)*, with an aim to provide institutional guarantee for the BRITACEG.

## 2.2 Major Achievements

### 2.2.1 Curriculum development

The BRITACEG delivers its training through three main types of programs. The first is independent programs, relying on BRITAs' own training resources, or courses pre-recorded by teachers and experts selected by the BRITACEG, where the BRITACEG bears full responsibility. The second is cooperation programs, jointly hosted by tax authorities and relevant international organizations, with the latter responsible for curriculum and experts, and the BRITACEG in charge of tasks such as enrollment. The third is programs hosted by other cooperation institutes.

For independent programs, considering the development targets of the BRITACOM, the BRI jurisdictions' conditions as regards tax environment and administration capacity, practical and professional needs, the BRITACEG has designed and established the current "3+N" framework for training. This framework is designed after soliciting opinions and suggestions from BRI jurisdictions, solid and robust enough as a proactive response to tax governance challenges posed by new global economic trends and new business models arising thereof, that are compounded by a pandemic unseen in a century. The "3" here means three topics, namely tax dispute resolution, digitalization of tax administration, and taxpayer service, and the "N" refers to topical tax issues to be selected amid the current evolving dynamics in the international economy and taxation. The VAT reform has now been chosen as the first topic. Next, programs on other tax topics will be released as needed.

The course system is divided into three levels based on the difficulty level, namely elementary, intermediate and advanced. Elementary courses present mainly basic knowledge, on top of which intermediate courses add case studies and more in-depth discussion. Advanced courses, besides incremental contents and difficulty, will involve expert lectures and seminars. Of these three levels of courses, the elementary ones will all be held online, while intermediate and advanced ones are expected to be conducted either online or offline.

Based on the design features of the BRITACEG training, the BRITACEG, drawing on the common practice adopted by international organizations, has developed a certificate system in which the trainees of three levels received course completion certificates signed by BRITACOM leaders of different levels. Currently, the elementary-level certificate signed by the president of BRITA·Yangzhou has been issued on a trial basis for elementary course completers.

### 2.2.2 Academy building

At present, the BRITACEG has established four BRITAs respectively in Yangzhou China, Beijing China, Nur-Sultan Kazakhstan, and Macao SAR, China. The above-mentioned two sets of regulations, namely the *Detailed Rules of the Belt and Road Initiative Tax Administration Capacity Enhancement Group (draft version)* and the *Regulations of the Belt and Road Initiative Tax Academies (draft version)*, formulated by the BRITACEG, have set consistent standards and norms in the academy building, curriculum design, faculty training as well as enrollment threshold, thus providing institutional guidance for BRITACOM Council Member Tax Administrations and Observers to join the BRITACEG and build tax academies, and promoting the exemplary experience of existing academies. After multiple rounds of expert consultation and revision, the BRITACEG has received opinions and suggestions from its members and partners for further refinement. The finalized regulations will be circulated among relevant parties as operation guidance and standards of the BRITACEG.

In 2022, a task force has been established by the BRITACEG. It works in close collab-

oration with the BRITA in Yangzhou in an effort to build BRITA·Yangzhou into a "flagship" academy to drive the development of other BRITAs, thus strengthening exchanges and cooperation with relevant international organizations and professional institutions, and boosting resource sharing and mutual learning in multiple areas such as training, research, and technical assistance.

**2.2.3 Faculty building**

To build a versatile faculty featuring global vision, diversity, and expertise, the BRITACEG makes continuous efforts to expand its team. As a pilot, some trainers in the STA Trainers Pool have been selected for the BRITACEG teaching team, thereafter, the BRITACEG is considering to expand the recruitment of trainers among other BRITACOM Parties. Their collective expertise covers multiple lines of tax, including international taxation, taxpayer service, tax administration and information technology, and large enterprise tax management. In November 2020, the BRITACEG held a dedicated training session for the faculty and worked out a preliminary training plan around such topics as academy building, course management, and faculty training. Meanwhile, the BRITACEG has taken steps to absorb more trainers into its team. To expand cooperation, the BRITACEG continues to mobilize tax administrations of participating jurisdictions, as well as international organizations and academic institutions involved, and give full rein to the professional strengths of the BRITACOM Advisory Board. Up till now, the BRITACEG has already started communication with relevant overseas universities, international organizations, and other institutions, in a bid to invite their experts to join the teaching team. All these efforts will contribute to enhancing expertise and authoritativeness of the teaching team, as well as sharing international practices and expert experience effectively.

## 3. Outlook for the BRITACEG

### 3.1 Challenges

Enhancing tax administration capacity to achieve inclusive and sustainable development in taxation is essential in the quality pursuit of the BRI. At present, many BRI jurisdictions are facing varying challenges in tax governance and capacity building, such as a relatively weak foundation for tax administration, deficient taxpayer compliance, and inadequate tax transparency. Due to the late start in international tax cooperation, some jurisdictions have received limited external assistance, making it difficult to carry out systematic training in a well-organized manner. At the same time, changes in the current business environment, such as the deepening of economic globalization and the emergence of new economic forms and business models, make it difficult for traditional international tax rules to adapt. Risks mount up in base erosion and profit shifting, and so do the challenges posed by the digitalization of the economy. Facing this new circumstance, tax authorities all over the world, including those in the BRI jurisdictions, must endeavor to build up capacities and improve the effectiveness and efficiency of tax administration through more effective tax policies and broader tax cooperation.

Since the fourth quarter of 2021, the BRITACEG has taken phased steps to launch four elementary online courses, covering dispute resolution, digitalization of tax administration, VAT reform, and taxpayer service, which were open until 15 April 2022. Trainees surveyed provided generally positive feedback, expressing their sense of benefit in terms of work and study, and their willingness to apply the knowledge and skills acquired to their practices in the future. Compared with in-person training, online learning platforms allow for a larger coverage of trainees and provide unified contents and flexible schedules, thus enjoying increasing popularity with developing jurisdictions. To jointly meet challenges brought by the pandemic, some international organizations, like the OECD and the IMF, are also actively developing and implementing online capacity-building programs.

### 3.2 Short-Term Plans

Online training, amid the pandemic, is a natural choice for a good many working scenarios, and the best approach to managing both pandemic control and daily work. The BRITACEG, giving full play to the positive role of web-based platform in building capacity for tax administration, has worked to establish online teaching platforms through the official websites of the BRITACOM and the BRITAs. It also made efforts to improve procedures of learning and assessing including enrollment, attendance, examination, evaluation, and certificate issuance. Thanks to these platforms, the BRITACEG is able to develop online training programs that register broader reach, larger scale, and expanded topics. In addition, the design of the intermediate and advanced curricula is in

progress on the selected topics such as tax dispute resolution, digitalization of tax administration, taxpayer service, and VAT reform. In the meantime, the BRITACEG follows closely the frontiers of international taxation to design detailed courses and makes these courses more enriched based on the topical tax issues of common concern. To help trainees better consolidate the knowledge they have learned, the BRITACEG has designed supporting tests and will issue completion certificates to those who have passed corresponding exams. Furthermore, the BRITACEG has worked progressively to compile manuals and materials used in training into topic-specific textbooks. These textbooks will be translated into multiple languages afterward for use by the BRITAs around the world. Moreover, new forms of learning have been developed to carry out virtual field studies, such as virtual tours and exhibitions.

A high-caliber faculty is an important guarantee for the development of the BRITACEG. In the next step, the BRITACEG will create synergy for capacity building by fully integrating expert resources from BRITACOM Member Tax Administrations, Observers, and other relevant parties. Meanwhile, to bring together quality training resources and build a versatile faculty characterized by global vision, diversity, and expertise, the BRITACEG will set up a regular cooperation mechanism with relevant international organizations, prestigious universities, research institutions, industrial associations, multinational companies, and international accounting firms.

In terms of academy building, in addition to the existing BRITAs situated in Yangzhou China, Beijing China, Nur-Sultan Kazakhstan, and Macao SAR, China, which use Chinese, English, Russian, and Portuguese to deliver training respectively, BRITAs with the ability to provide training in more languages will be built to offer targeted training services for more tax officials from BRI jurisdictions. Efforts will also be made to encourage exchanges and cooperation between the BRITAs and world-renowned universities as well as research institutions, proactively carry out policy research and academic exchanges amongst BRI jurisdictions, and explore new ways to achieve an in-depth sharing of global advanced experience in terms of tax governance and service. With all these efforts, the tax administration capacity of BRI jurisdictions is expected to see sustained improvement.

### 3.3 Development Vision

As a substantial practice of building a community with a shared future for mankind, and in line with the principle of achieving shared growth through consultation and collaboration, the BRI has fully shown openness, inclusiveness, and mutually beneficial cooperation. The BRITACEG, an essential element of the BRITACOM, is committed to building an inclusive and sustainable platform for capacity building, in a bid to promote the establishment of a growth-friendly tax environment and secure more achievements in the high-quality pursuit of the BRI.

The BRITACEG will seek to improve the whole-process management of capacity-building programs. In-depth researches and surveys on the demands for enhancing tax administration capacity building of BRI jurisdictions will be conducted regularly to accurately analyze and identify priority areas for this endeavor. Next, the BRITACEG will carry out a variety of capacity-building programs on the sharing of best practices in other key areas, and track the effects of their implementation to accumulate more experience, thus creating a virtuous cycle of continuous refinement.

Going forward, the BRITACEG will continue to serve as a bridge in tax exchanges and cooperation, and lay a more solid foundation for international taxation cooperation. It will also persevere in its endeavors to raise tax certainty, digitalize tax administration, improve tax environment and strengthen tax administration capacity building. With all these efforts, the BRITACEG will surely make significant contributions to closer BRI partnership, accelerated global economic recovery, deepened economic globalization, and the building of a community with a shared future for mankind.

# Enhancing Tax Administration Capacity Building

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***Abstract:*** This article tracks how OECD capacity building has evolved since 1992, alongside the evolution of international taxation, tax administrations, and their needs for support. In doing so it identifies some of the key lessons for tax administrations and their partners in building the capacity to respond to the current challenges and opportunities. It places a particular focus on digitalisation and the implications for tax administrations, both in respect to the implementation of the Two-Pillar Solution to the taxation of the digitalising economy, and digitalisation of the tax administration itself.

***Keywords:*** Tax administration; Capacity building; Digitalisation

Tax administration has seen rapid changes in recent years. Digitalisation is changing how tax administration is undertaken, enabling real-time information and big data analytics, while changes in international tax policy are providing administrations with new approaches, new tools and more information than ever before. Taken together this creates a period of significant opportunity for tax administrations, but only where there is the capacity in place to seize these opportunities. Enhancing tax administration capacity building is therefore of increasing importance.

This article looks at the evolution of capacity building programmes developed by the Organisation for Economic and Co-operation Development (OECD), including a more in-depth focus on two of the most pressing challenges facing tax administrations in the coming years: the implementation of the Two-Pillar Solution to the taxation of the digitalising economy, and digitalisation of the tax administration itself.

Drawing from this experience it is clear that capacity building is a dynamic process, and there is a need for innovation and adaptation to respond to the changing needs of tax administrations themselves. Key lessons that emerge from the OECD experience include the high value placed on peer-to-peer learning, the importance of identifying the various stages of support needed for major reforms and providing specific tools for each stage, and the benefits of working in partnership to deliver capacity building.

## 1. The Evolution of Tax Administration Capacity Building: Efforts of the OECD

The OECD began providing capacity building to tax administrations in 1992 with the establishment of the Global Relations Programme on Taxation (GRP). Initially established as a programme to support countries transiting to market economies, the GRP expanded dramatically in the following years. Now a truly global programme, over 50 workshops a year are being delivered through six multilateral tax centres around the world, and through other host countries. Over 20,000 tax officials have benefitted from training through these intensive workshops on a broad range of topics related to international taxation.

More recently, the GRP has expanded to provide virtual learning too. Launched in 2019, the OECD e-learning programme has expanded significantly since, not least due to the dramatic increase in demand during the COVID pandemic, when physical workshops had to be suspended. The e-learning offering now encompasses 19 modules, most of them available in three different languages, covering a range of topics including Exchange of Information (EOI), Base Erosion and Profit Shifting (BEPS), Transfer Pricing, Tax Treaties, Tax Crime, Tax Administration and VAT. Over 30,000 tax officials have participated in the e-learning programme since its launch. Additionally, the GRP participates in the Virtual Training to Advance Revenue Administration (VITARA) e-learning project — created jointly by the Inter-American Center of Tax Administrations (CIAT), the International Monetary Fund (IMF), the Intra-European Organisation of Tax Administrations (IOTA) and the OECD. VITARA offers online courses covering institutional arrangements, management of strategic reforms, compliance risk management, information technology and data management, as well as design and management of core taxation processes.

In addition to multilateral training, from 2012 the OECD began providing bilateral capacity building to tax administrations on transfer pricing, and BEPS, following the launch of the BEPS project. Since then, over 40 countries have benefitted from bespoke bilateral assistance. This assistance is tailored to the needs of the recipient country, and can cover support in the legislative process, as well as organisational reform in the tax administration, and building specific skills in transfer pricing and implementation of the BEPS Actions.

One challenge in providing capacity building in tax administration has historically been that it has not been possible for external support to assist on live cases, in real time, due to legal restrictions and the need to guarantee taxpayer confidentiality. This meant that the final stage, where theory turns into practice, and revenues are raised, had been least served by capacity building support. To address this gap, Tax Inspectors Without Borders (TIWB) was established as a joint initiative of the OECD and the United Nations Development Programme (UNDP) in 2015. By using a practical "learning by doing" approach, experienced tax auditors work alongside officials in developing countries to share their knowledge and experience of auditing multinational enterprises by working hand-in-hand with them on current audit cases. The narrow and specific emphasis on assisting audits in real time distinguishes TIWB from the mainstream of existing international tax assistance.

Owing to the success of the TIWB initiative, developing countries have expressed a desire for similar technical assistance in other areas of taxation. Consequently, the TIWB audit assistance model is now being applied to criminal tax investigations and pilot programmes for the effective use of information exchanged automatically (AEOI) between governments, both of which help fight illicit financial flows (IFFs). Further application to accompany developing countries in the taxation of natural resource contracts, taxation and the environment, and digitalisation of tax administration (see below) is being explored.

While the TIWB initiative deployed its programmes globally and launched its 100$^{th}$ programme in January 2022, Asia-Pacific and Eastern Europe are two regions where countries' assistance requests have been growing. To date,

26 programmes have been deployed in 16 jurisdictions[1] of the regions.

Benefits of TIWB programmes include tax revenue gains collected on audits supported by TIWB experts. Around the world, more than USD1.6 billion additional tax revenues have been collected through TIWB and TIWB-style assistance offered in collaboration with the African Tax Administration Forum (ATAF) and World Bank Group. Of this, USD290 million were generated by TIWB programmes in Asia-Pacific and Eastern Europe.

Since 2011, the Secretariat of the Global Forum on Transparency and Exchange of Information for Tax Purposes[2] has been supporting developing countries (more than half of its 163 members) to implement and benefit from the tax transparency standards (EOI on request and AEOI) to better fight tax evasion and other IFFs and enhance domestic resource mobilisation. Over the last decade, it has trained over 22,000 officials, developed 9 toolkits and 6 e-learning courses and successfully launched 4 regional initiatives (Africa, Latin America, Asia and Pacific) to advance the tax transparency agenda locally.[3] Following its strategic approach to technical assistance which is based on agreed work plan with each country,[4] it provided technical support to 75 developing countries in 2021. In this context, EUR30 billion of additional revenues were identified by developing countries through offshore tax investigations and voluntary disclosure programmes.

## 2. Supporting the Implementation of the Two-Pillar Solution

When looking at the next set of capacity building needs for tax administrations, the implementation of the Two-Pillar Solution to taxing the digital economy is the most obvious area. The BEPS Inclusive Framework recognises the ambitious nature of the timelines to implement the Two-Pillar Solution and so the Detailed Implementation Plan, published on 8 October 2021, includes a commitment to provide bespoke technical assistance through all phases of implementation. This will be vital for developing countries to reap the benefits of the Two-Pillar Solution in order to support domestic resource mobilisation.

The Two-Pillar Solution has a number of components, each of which must be elaborated through rules that will find their way into domestic legislation or international agreements. The process for finalising these rules and agreements is currently on-going, according to the target deadlines set out in the Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy. For example, the Global Anti-Base Erosion (GloBE) rules to give effect to the global minimum tax were already agreed by the Inclusive Framework in December 2021. Jurisdictions are now able to use those rules as a basis to incorporate them into domestic law. Indeed, the European Union is already debating a draft Directive for implementation of the GloBE rules under EU law. The Inclusive Framework continues to work on finalising the Commentary for the GloBE rules, as well as an implementation framework to ensure a coherent and coordinated application of the rules in practice.

Separately on Pillar 1, the substantive rules for giving effect to Amount A are being discussed in the relevant working parties and the text of a Multilateral Convention (MLC) is being elaborated. The analytical work to articulate Amount B is going on as well as discussions

1 Albania, Armenia, Bhutan, Cambodia, Georgia, Kazakhstan, Kosovo, Malaysia, Maldives, Mongolia, Pakistan, Papua New Guinea, Sri Lanka, Thailand, Ukraine and Viet Nam.

2 https://www.oecd.org/tax/transparency/resources/.

3 OECD (2022). *2022 Global Forum Capacity Building Report*, https://www.oecd.org/tax/transparency/documents/capacity-building-report-2022.htm.

4 OECD (2020). *Capacity Building: A New Strategy for the Widest Impact*, https://www.oecd.org/tax/transparency/what-we-do/technical-assistance/Capacity-Building-Strategy.pdf.

on how to finalise the details of the Subject to Tax Rule (STTR) of Pillar 2. All of this work is aimed to be completed in 2022 with the goal of bringing the Two-Pillar Solution into effect in 2023. Once the rules are in effect, tax administrations will have to interpret and apply them.

Consequently, there are three distinct phases of support: finalisation of the rules, followed by legal implementation, and finally implementation in practice.

First, Inclusive Framework members will need help participating in the immediate work of finalising the technical work on the two pillars. The outputs of this work will include a Multilateral Convention to implement Amount A of Pillar 1, along with an Explanatory Statement, development of Amount B, model rules and commentary for the implementation of the GloBE rules of Pillar 2, a model STTR provision and a Multilateral Instrument (MLI) to implement it. Here the capacity needs are primarily in ensuring that participants from developing countries are able to keep up with the pace of discussions, and are able to access expertise to provide further explanation on the proposals. In addition, given the limited capacity within many developing countries to model the economic impact of the proposals, data provided by the OECD Secretariat to Inclusive Framework members will be vital in helping countries understand the impact of the Two-Pillar Solution.

Once these outputs are finalised, the second phase of support will be geared more towards bespoke assistance on a bilateral basis to implement the rules into domestic law or treaties and to ensure that ratification processes proceed in a timely fashion. This may include assisting with draft legislation or supporting interaction at the political level to assist with signature or ratification of the MLC or MLI.

The third phase may include support for administrative cooperation, including auditing taxpayer's liability under Amount A (including reviewing documents and information provided by the taxpayer) and assistance in participation in multilateral tax certainty processes (e.g., as members of a panel convened to rule on the effect of Amount A in respect of a specific taxpayer), assessing whether a transfer pricing dispute could be resolved through the application of Amount B, or whether withholding tax on a payment is affected by the STTR.

## 3. Supporting the Digitalisation of Tax Administration

Recent technological changes have opened up a range of opportunities for tax administration improvements through digitalisation. Such changes may increase revenue by expanding the tax base or through more effective collection. They may increase efficiency and effectiveness through simplifying processes, using cheaper and more accessible digital channels to interact with taxpayers, moving to more self-service approaches, and exploiting data to focus on resources more effectively. They may reduce taxpayers' administrative burdens by making it easier to comply with obligations. Finally, they may help drive profound and significant changes, as the move towards a digitalised tax administration can help drive wider digitalisation across government and society.

This has led to a series of initiatives from international organisations and jurisdictions to support developing country tax administrations in their digitalisation journeys, ranging from bilateral shoulder-to-shoulder assistance[5] to large-scale projects. In this context, the Forum on Tax Administration (FTA) in the OECD, with its global representation and significant collective experience, is well positioned to assist tax administrations with capacity building through its initiatives, including peer-to-peer assistance.

The FTA has an ongoing focus on the digitalisation and digital transformation of tax administrations, as outlined in the discussion document "Tax Administration 3.0: The Digital Transfor

5 Exemplified through the Tax Inspectors Without Borders programme: http://www.tiwb.org/.

mation of Tax Administration"[6] and the corresponding Action Plan[7]. This focus, combined with an expressed intention to offer capacity building initiatives that complement the offers from other organisations, has over the last year been materialised in a coherent package of initiatives that may benefit tax administrations in the Belt and Road jurisdictions in their digitalisation journey. The package consists of the following elements, which are summarised here and described below:

- The publication of a Digital Transformation Maturity Model (DTMM) to assist administrations in self-assessing their current level of maturity and to help inform digitalisation strategies.
- The development of a new Inventory of Tax Technology Initiatives (ITTI) which will allow tax administrations to see, on the basis of a global survey, the uptake of new technology initiatives at a jurisdiction level and to access a range of supporting material, from reports to case studies.
- The publication of the report "Supporting the Digitalisation of Developing Country Tax Administrations" which examines the common elements of successful digitalisation journeys and the benefits they deliver.
- The planned piloting of a proposed Tax Inspectors Without Borders-Digitalisation of Tax Administration (TIWB-DTA) programme, aimed at providing confidential advice on high-level decision-making on strategic topics related to digitalisation.

The elements of the package can be applied in any order, and Figure 1 shows the possible natural flow.

### 3.1 Digital Transformation Maturity Model

The Digital Transformation Maturity Model[8] was published at the FTA Plenary in December 2021. The model covers five levels from emerging to aspirational. In addition to its role in helping administrations understand their current level of maturity and possible reform pathways, experience from the use of this and previous FTA maturity models shows that the discussions involved in reaching a view are often of high value in and of themselves, often bringing together officials from across the administration, including at senior levels.

So far, 46 tax administrations have provided their self-assessment results to the Secretariat.

The facilitation of self-assessments is key to the quality of the discussions, including any necessary preparation and evidence gathering. The FTA considers helping in the proper facilitation of maturity model discussions by:

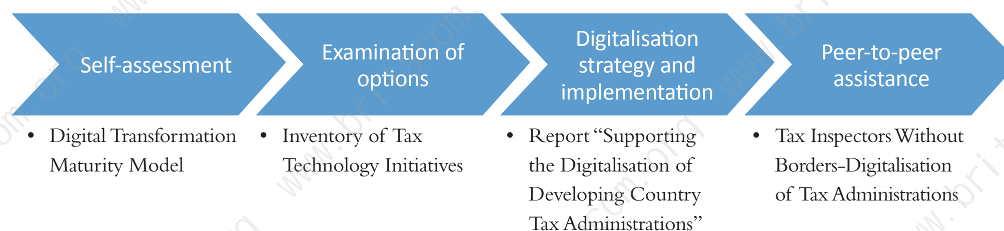


Figure 1. The natural flow of the elements of the package

6 OECD (2020). *Tax Administration 3.0: The Digital Transformation of Tax Administration*, https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/tax-administration-3-0-the-digital-transformation-of-tax-administration.htm.

7 OECD (2022). *Tax Administration 3.0 — Action Plan Update*, https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/tax-administration-3-0-action-plan-update.pdf.

8 OECD (2022). *Digital Transformation Maturity Model*, https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/digital-transformation-maturity-model.htm.

- Producing an e-learning module and step-by-step guidance;
- Putting in place a pool of "expert facilitators" (including the training of those experts); and
- Involving the FTA Secretariat in facilitating some of the discussions.

### 3.2 Inventory of Tax Technology Initiatives

While there is internationally comparative data on tax administration, collected through surveys such as the International Survey on Revenue Administration (ISORA)[9], such data usually describe the whole range of functions and processes of a tax administration on a high level, and may not examine in detail the digitalisation and digital transformation initiatives undertaken by tax administrations.

In order to fill this information gap, a new Inventory of Tax Technology Initiatives has been developed by the OECD, and badged as a partnership with eight regional and international organisations.[10] The Inventory was made public in April 2022.

ITTI's primary purposes are to assist tax administrations in their considerations of possible domestic reforms and to help identify where future collaboration between tax administrations might be of most value.

Its information covers both (i) leading technology tools and digitalisation solutions implemented by tax administrations, and (ii) approaches that will help advance the overall digital transformation of tax administrations. In addition to providing a snapshot of which administrations have adopted particular technology tools or approaches, ITTI also contains links to case studies providing a more in-depth look at particular implementation solutions as well as links to supporting materials and studies.

ITTI is based on a survey developed by FTA member administrations and the FTA Secretariat. More than 75 administrations have completed the survey so far. As more administrations complete the survey and become part of the inventory, the benefits for those using ITTI increase.

The FTA Secretariat plans to increase the relevance of ITTI to developing countries through:

- supporting developing country administrations with the completion of the comprehensive survey through hands-on outreach;
- providing assistance with the development of case studies to help them showcase their work; and
- demonstrating the platform and how to use it to maximise the benefit.

### 3.3 Building on the Capacity Building Report on Digitalisation

The purpose of the report "Supporting the Digitalisation of Developing Country Tax Administrations"[11], prepared in collaboration with the ATAF and published in December 2021, is to share information that will assist developing country tax administrations as they consider digitalisation, to facilitate dialogue among tax officials on tax administration issues, and to identify opportunities to improve tax administration information and communications technology (ICT) systems.

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9 https://data.rafit.org.

10 Partner organisations: The Asian Development Bank (ADB); the African Tax Administration Forum (ATAF); the Cercle de Reflexion et d'Echange des Dirigeants des Administrations Fiscales (CREDAF); the Commonwealth Association of Tax Administrators (CATA); the Inter-American Center of Tax Administrations (CIAT); the International Monetary Fund (IMF); the Intra-European Organisation of Tax Administrations (IOTA); and the Study Group on Asia-Pacific Tax Administration and Research (SGATAR).

11 OECD (2021). *Supporting the Digitalisation of Developing Country Tax Administrations*, https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/supporting-the-digitalisation-of-developing-country-tax-administrations.htm.

The FTA considers following up the publication of the report with other initiatives in order to maximise its effect:

- Outreach events: the purpose of these events will be to promote the report in order to increase its usage, and to collect feedback regarding areas where additional supporting material might be developed.
- Development of supporting materials: due to the scale and complexity of the issues involved in tax administration digitalisation, the report, while covering a large range of topics, only offers a relatively brief summary of each of the main issues. The FTA considers working with developing country tax administrations and other stakeholders on the production of further guides, providing a more detailed examination of specific aspects of the digitalisation journey. The guides would be produced following the same principle as the original report, i.e., the content should be based on actual tax administration experience in order to facilitate peer-to-peer learning.

### 3.4 Tax Inspectors Without Borders for Digitalisation of Tax Administrations (TIWB-DTA)

The FTA and TIWB Secretariats are currently exploring whether there is need and capacity to assist tax administrations in developing countries through confidential advice on high-level decision-making on digitalisation strategies, architectural options, budgetary considerations, management of digitalisation projects and other strategic topics related to digitalisation.

A meeting of FTA Commissioners and Senior Officials in 2021 demonstrated strong interest in the development of light-touch collective mechanisms for providing additional support to developing country tax administrations in the area of digitalisation. A key caveat was that such mechanisms should not duplicate the efforts of international organisations, regional tax organisations or individual FTA members on long-term support for digital infrastructure projects, nor involve very large resource commitments. Several Commissioners highlighted TIWB as the kind of model that could be used for this work, which would allow for high-value confidential interactions at critical points.

A concept note was developed in 2021, outlining that FTA members can join TIWB-DTA missions as partners, offering assistance to host administrations from within and outside the FTA on high-level strategic topics related to digitalisation, and that the concept would be tested through pilots prior to the formal decision to start.

The FTA is currently organising pilots testing the concept in collaboration with the TIWB Secretariat. In each pilot, a Host administration will receive assistance from one or more Partner administrations in the form of confidential advice on topics like digitalisation strategies, architectural options and budgetary considerations.

## 4. Conclusion

The need for capacity building to continue to evolve will persist in the coming years, especially in relation to digitalisation, both in terms of taxation of the digital economy and digital taxation processes. The OECD Secretariat and the FTA have shown the ability to adapt and reform capacity building to the needs of countries, and the OECD is committed to continuing to harness international expertise to deliver targeted and relevant assistance.

# Enhancing the Capacity of Tax Administrations to Develop Tax Policy *

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***Abstract***: Building capacity in tax administrations will be key in coping with the new challenges arising from the new ways of doing business. This article discusses three topics that will require the building of new assessment and tax collection capabilities within tax administrations, namely: the digital economy, cryptocurrency taxation, and environmental taxation. It proposes issues

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that will require further attention and consideration by tax administrations wishing to collect the rent attributed to these activities. It is contended that new capacities will have to be developed not just to handle the "new" forms of doing business, but also to generate income and to allow for a harmonized environment that facilitates and draws investment to Belt and Road Initiative jurisdictions. The transformation ought to occur while "traditional" issues in international tax administration and cooperation persist.

***Keywords***: International tax; Digital economy; Climate change; Cryptocurrency; Belt and Road Initiative; Tax administration; Capacity building

## 1. Introduction

The Belt and Road Initiative (BRI)[1] aims to facilitate trade and investment for the purpose of fostering economic growth in an area stretching from East Asia to Europe. Tax policy is central to both trade and investment, since tax systems shape incentives for inbound and outbound investment. That's why getting agreement on coordinated measures to foster tax policy development for BRI jurisdictions will be a key feature of the work going forward.

What role is to be played by the BRI in obtaining cooperation and harmonization in tax policy?

Broadly speaking, the number of jurisdictions taking part in the BRI is large, and their tax systems vary, as do their capacities for tax collection and management.[2] Therefore, devising or adhering to rules that are capable of reducing taxpayer risks when investing in those jurisdictions will be key to creating a favorable environment for investment that is also facilitated by cooperative networks of integration and harmonization of tax rules.

Against this backdrop, this article will focus on three main "novel" topics which should be up for discussion and consideration by tax authorities involved in the BRI when developing tax policies that are apt to handle the new ways of doing business:

(i) Digital economy: Taxation of the digital economy either through the implementation of the Pillar 1 approach as defined by the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework, or through the application of unilateral digital taxes.

(ii) Cryptocurrency taxation and the use of blockchain to gain efficiency in tax administration structures.

(iii) Environment: The pricing of environmental externalities through the application of carbon taxes and other environmental taxes bearing an indirect price on carbon.

New capacities will have to be developed not just to handle the "new" forms of doing business, but also to generate income and to allow for a harmonized environment that facilitates and draws investment to the region. The transformation ought to occur while "traditional" issues in international tax administration and cooperation persist. Transfer pricing disputes and other issues related to the allocation of taxing rights between states, tax planning and arbitrage by taxpayers, curbing tax avoidance and evasion, and the streamlining of international dispute resolution and exchange of information procedures are ongoing challenges for tax administrations, even as they are required to deal with the challenges deriving from fast-paced development of new technologies and business practices.

The next section explores some of these

1 *BRITACOM*, https://www.britacom.org/jzgk/britacom/.

2 C. Jingxian (2019). Tax Treaties: Past, Present and Future. 25 *Asia-Pacific Tax Bulletin* 5.

new challenges. Section three discusses how traditional challenges will coexist with emerging issues even as jurisdictions adapt to the new normal, and section four concludes.

## 2. New Challenges

### 2.1 Digital Economy

One of the biggest challenges faced by tax authorities in the last decade (and one that has topped the international tax agenda) is the taxation of the digital economy. The digitalization of the economy has allowed for the development of business models that can easily scale up without increasing local mass. As a consequence, enterprises are able to expand their presence in market jurisdictions (i.e. the jurisdiction where the target audience of the digital services is located) without a corresponding physical presence. Under the current rules, physical presence is a key factor for the allocation of taxing rights to a jurisdiction. Thus, market jurisdictions — the jurisdictions that are responsible for a large part of the value created by the digital economy — are prevented from taxing a fair share of the large profits generated by enterprises active in the digital economy.

For the purpose of righting this wrong and to allow the taxation of value where value is created, the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) has set out to develop new rules to allow for the taxation of a fraction of multinational enterprises' (MNEs) residual profit (i.e. excess profit beyond 10%) in the market jurisdiction. As the negotiations stand today, these new rules — known as the Pillar 1 allocation rules — will apply to all cross-border business activities, not just digital services. The initial impact of Pillar 1 will be limited, given it has a restricted personal scope of application in its first phase of implementation.[3] Only MNEs with a global turnover above EUR20 billion and profitability above 10% are initially covered by the new rules.[4]

According to recent research conducted by Oxford University[5], the Pillar 1 approach envisioned in the OECD blueprint will only apply to approximately 100 multinational entities across the world. The new proposed allocation rules would only apply if enough revenues are generated in a jurisdiction to reduce compliance costs in tracing small amounts of sales. As a result, only jurisdictions that are assigned revenues[6] of over EUR1 million or EUR250,000, depending on whether the jurisdiction has an annual GDP greater or lower than EUR40 billion, are entitled to receive allocation of a fraction of the residual profits. Regulated financial services and the extractive sector are expected to be outside the scope of Pillar 1.

Therefore, tax administrations will need to assess the transactions occurring in the market to know whether they are eligible for the allocation of income under the scoping rule (of EUR20 billion), and the nexus rule (minimum revenue per jurisdiction). This assessment will be needed irrespective of whether the revenues are ultimately assigned to the jurisdiction. The legislative framework embodied in the jurisdiction in question will be determinant in defining the role that is to be played by tax administrations going forward.

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3 The revenue threshold may be lowered to EUR10 billion after seven years, contingent on successful implementation of the rules.

4 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-october-2021.pdf.

5 M. Devereux & M. Simmler (2021). Who Will Pay Amount A?. 5 *EconPol Policy Brief* 36, https://www.econpol.eu/sites/default/files/2021-07/EconPol_Policy_Brief_36_Who_Will_Pay_Amount_A_0.pdf.

6 Revenues mean the total revenues of a group after the exclusion of revenues derived from extractive and regulated financial services.

Furthermore, a question persists as to whether the new allocation rules, which are yet to be completed, will allocate enough revenue to the market jurisdiction to justify extensive investment in capacity development of tax administrations to be able to assess the tax locally. Research is still pending on the revenue generation potential, particularly for middle- and low-income BRI jurisdictions. This research would probably only be viable once the final rules are disclosed. However, preliminary economic studies conducted by the OECD[7] indicate that most economies would experience a small tax revenue gain, assuming a 20% reallocation of residual profit[8] to market jurisdictions. The same research indicates that, on average, low- and middle-income economies would gain relatively more revenue than advanced economies, while investment hubs would experience some loss in tax revenues.

However, jurisdictions are still receiving mixed messages. An IMF study indicates that whereas high- and upper-middle-income jurisdictions like Australia, Japan, Korea and China, with large domestic markets, would gain revenue from the application of a Pillar 1-type allocation, developing jurisdictions such as Vietnam could lose revenue.[9]

A remaining question is whether the simple administration of unilateral digital services taxes in the form of gross excise taxes would generate more revenues and be easier to implement, using fewer human resources from already understaffed tax administrations. Although unilateral digital services taxes are more open to tax avoidance and tax competition,[10] this is a question that is being put forward in low- and middle-income fora like the African Tax Administration Forum[11] and that would be equally interesting for BRI jurisdictions.

The newly published draft Model Rules for Nexus and Revenue Sourcing on Amount A[12] propose specific source rules to assign an MNE's revenue to a specific market jurisdiction. The proposed rules denote a shift from a group approach to a transaction-by-transaction approach, focusing on individual items capable of generating revenue (such as clicks on an online advertisement). This shift, which is built on existing foundations such as the arm's length standard and the separate entity approach, is likely to require greater capacity from tax administrations, both to adapt to the new rules and to oversee the transactions covered (in the market jurisdiction), in order to source the revenue.

The shift from group to transactional-based revenue allocation between jurisdictions creates the need for the application of formulaic allocation keys. For example, there may be multiple items on one invoice or contract, and goods or services may be sold in different jurisdictions and difficult to allocate to one geographic location using the sourcing rule. The sourcing of revenues in this case is done by resorting to a

7 OECD, Tax Challenges Arising from the Digitalization of the Economy, Update on the Economic Analysis and Impact Assessment, Webcast, 13 February 2020.

8 Under this OECD study, residual profit is defined with a 10% or 20% threshold on profit-before-tax to turnover. It must be noted that under the current proposal, the residual profit is of 10% and the allocation fraction is 25% of residual profit.

9 Era Dabla-Norris, Ruud De Mooij, Andrew Hodge, et al. (2021). *How to Tax in Asia's Digital Age*, https://blogs.imf.org/2021/09/14/how-to-tax-in-asias-digital-age/.

10 Era Dabla-Norris, Ruud De Mooij, Andrew Hodge, et al. (2021). *How to Tax in Asia's Digital Age*, https://blogs.imf.org/2021/09/14/how-to-tax-in-asias-digital-age/.

11 African Tax Administration Forum (2020). *ATAF Publishes an Approach to Taxing the Digital Economy*, https://www.ataftax.org/ataf-publishes-an-approach-to-taxing-the-digital-economy.

12 OECD (2022). *Pillar One — Amount A: Draft Model Rules for Nexus and Revenue Sourcing, Open Consultation Document*, https://www.oecd.org/tax/beps/public-consultation-document-pillar-one-amount-a-nexus-revenue-sourcing.pdf.

formulaic approach to allocate the revenue in proportion to the revenue earned in each market, using an allocation key. The allocation key basically applies to the "vacant" portion of the revenue that cannot be sourced to any particular market on a transaction-by-transaction basis.

The proposed Pillar 1 source rules are still in draft form and subject to consultation and revision procedures. Yet the level of complexity reported is likely to demand a larger effort from tax administrations across the world to monitor, review, and verify these transactions. Transfer pricing ramifications are also likely to derive from the formulaic allocation of income, which could trigger disputes through the existing mutual agreement procedure in tax treaties.

Since mutual agreement procedures are typically a function of tax administrations, BRI jurisdictions would have to be ready to negotiate with each other, but also on a more global scale, as many of the transactions covered by large MNEs are likely to be in high-income jurisdictions.

The use of blockchain applications, as discussed in section 2.2, might be a useful tool to monitor these transactions if new capacities are developed to monitor MNE transactions through a digital platform.

## 2.2 Challenges Associated with Blockchain Applications and Cryptocurrency Taxation

### 2.2.1 Challenges

It has been predicted that blockchain technology has the potential of revolutionizing the manner in which business is conducted. Blockchain promises the elimination of intermediaries, as well as inserting trust, transparency, and improved access to shared information and records which would be instrumental in implementing, for example, the new Pillar 1 allocation rules.

Blockchain applications have been developed or are currently being developed for an array of markets and industries, mostly to streamline business operations. The most notable applications of blockchain technology involve the creation of virtual assets like cryptocurrencies and asset tokens. Both the rise of cryptocurrency ownership and trade, and the recent "tokenization" of assets pose specific challenges to tax administrations worldwide.

Cryptocurrencies are digital currencies designed to work as a medium of exchange (or a store of value) through a computer network that is not reliant on a central authority. Especially in developing jurisdictions, cryptocurrencies have been embraced by citizens as a way of obtaining access to financial services — sometimes at reduced costs, such as in the case of remittances — or as a hedge against local inflation risk.

Virtual tokens are a challenge. In particular, non-fungible tokens (NFTs) are a type of token that is uniquely identifiable (unlike cryptocurrency coins), thereby providing a certificate of authenticity or proof of ownership. Tokens may be associated with all kinds of real assets, like physical or digital artworks, luxury goods, or real estate.

These fast-paced technological developments provide tax administrations with tremendous challenges. Detailed guidance on the tax treatment of these new types of asset ownership and their consequences for income, capital gains, and value-added tax (VAT) is often lacking, which results in uncertainty for taxpayers and, if the regulatory vacuum persists, increases in jurisdictions' tax gaps.

The decentralized nature of blockchain applications poses additional problems. For instance, the few commercial intermediaries that are involved in the cryptocurrency ecosystem (like cryptocurrency wallet-hosting companies or exchanges and cryptocurrency mining pools) are often situated in third jurisdictions. Due to their sui generis characteristics — they are not financial institutions — they largely fall outside the scope of the current standards for exchange of information employed under the auspices of the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes.

Tax lawmakers and tax administrations alike are advised to 1) develop tools to monitor and assess taxpayers' embrace of cryptocurrency and token technology; and 2) develop suitable tax regulatory guidance and sui generis tax regimes,

if needed. In the development of the guidance, the emphasis should be on increasing taxpayer compliance without stifling the economic growth potential of blockchain technology.

Since the embrace of cryptocurrencies is especially strong among citizens in developing jurisdictions, the need for capacity building on this matter is equally high in those jurisdictions. Given the complexity and novelty of the technological developments, international cooperation is key here, not only for the purpose of developing regulatory best practices for the taxation, but also to compel the international community to modernize the framework for the exchange of tax information.

### 2.2.2 Opportunities in using blockchain technology

Whereas the embrace of blockchain in the private sector poses challenges to tax administrations, the same technology also provides tremendous opportunities in the public sector, given its fundamental architecture as a decentralized peer-to-peer system for data management.

Key benefits associated with blockchain technology as a tool to support the assessment, collection, and execution of tax liabilities are transparency, efficiency, data integrity, and security. Especially in an international context, where information asymmetries between national tax administrations persist because there is no central authority, blockchain technology has the potential to revolutionize the administration of taxes.

In recent years, several use cases for blockchain technology have been developed to increase tax administration capacity. At the domestic level, the administration of wage withholding tax has been identified as a frontrunner for the implementation of the technology. By embedding smart contracts, a blockchain-based system can fully automate calculating and transferring tax and social security payments from employees' salaries to the relevant government agencies at the federal and/or state level.

Blockchain has also been suggested as a tool to reduce the administrative burden of VAT, one of the most important sources of government revenue in many jurisdictions. By adopting a decentralized reporting process in which

every VAT transaction would be conducted and reported in real time, VAT compliance burdens could be reduced dramatically. Furthermore, by using smart contracts embedded in the blockchain, all recorded transaction would be transparent and genuine, reducing the risk of fraud or mistakes. A real-time VAT return system also allows immediate insight in VAT subjects' finances, as the technology allows on-the-fly transfers of money between business and the government to settle outstanding liabilities and reimbursements.

In international tax, blockchain technology has been furthered as a tool to manage transfer pricing documentation of taxpayers that are active in multiple jurisdictions. Intra-group agreements and other transfer pricing documentation would be recorded on the blockchain, and tax administrations that need it would be given access and be able to track the flow of transactions and the identities of the relevant group companies. These features make blockchain technology the perfect vehicle to carry through information regarding country-by-country reporting but also, in the long run, reporting transactions occurring in a market jurisdiction under the new Pillar 1 allocation rules.

Finally, blockchain technology also has the potential to strengthen the OECD's Common Reporting Standard. Instead of exchanging information on taxpayers' finances bilaterally, a blockchain set up by a consortium of participating states can avoid data redundancies by registering all relevant information and by using smart contracts to allow access to eligible jurisdictions, thereby avoiding redundant data management and safeguarding the confidentiality of the information.

### 2.3 Environmental Challenges

The full implementation of an environmental fiscal reform translates into the ability to derive the environmental cost of doing business — a measure which should have been incorporated into jurisdictions' national tax policies long ago. One of the great issues from a policy perspective is the absence of a coordinated unit of measure to derive the environmental cost of doing business in a state. This leads to greater pressure on national states, to the extent that in the absence of a domestic carbon price policy, it is the government — and, with it, the whole society — that bears the environmental cost of doing business of all private and public enterprises at national level.

With growing commitments being assumed under the Paris Agreement, it is likely that governments will progressively introduce explicit and implicit prices on carbon, such as carbon taxes, fossil fuel taxes, and energy taxes. These market-based instruments can generate revenues, improve the efficiency of fiscal consolidation efforts, and play an important role towards fulfilling Nationally Determined Contributions.

Given the BRI's scale and its essential purpose of achieving economic growth across all participating jurisdictions, the establishment of a regionally endorsed environmental tax policy would be crucial to allow the internalization of negative environmental externalities. Furthermore, the policy choices made by the jurisdictions participating in the BRI will instruct the level of capacity needed to deal with the administration of such taxes at national level. For example, practice dictates that the administrative burden of an upstream carbon tax is much lower than if a jurisdiction opts to implement a downstream, or sectoral, carbon tax. An upstream carbon tax is a tax that is applied at extraction level in resource-rich jurisdictions and at import, or as close as possible to import, in resource-poor jurisdictions.

A carbon tax is a specific excise tax — a price per ton of carbon, usually applied by weight or volume. A carbon tax is relatively easy to administer, and the revenue-generating potential of an upstream carbon tax can be determined even before the tax is applied.

By knowing how much fossil fuel is employed in a process, then both the taxpayer and the tax administration can predict the amount of carbon tax revenue generated as a result of the combustion of that product. Because the correlation between the volume of a product and its carbon content is mathematical, the law

can apply pre-calculated tax rates without verifying actual emissions. The tax, expressed in terms of weight or volume, is based on the average carbon content of the relevant fuel.

An upstream carbon tax is preferable to a mid- or downstream carbon tax because it can provide a whole-of-economy approach, offering a level playing field between all sectors of the economy, with no cherry-picking for energy-intensive sectors. It is also capable of reaching both the formal and informal sectors, which is important in highly informal developing economies.

But carbon taxes can be employed at the downstream level too, in which case the item subject to tax is the carbon emission, and not the embedded carbon content of the fuel. In such cases, governments assign specific sectors that will be burdened by the tax. Since the tax is on emissions, there is also heavy reliance on monitoring, reviewing, and verifying processes.

In addition to taxing carbon, indirect carbon prices play an important role in trade as well as on environmental outcomes in the BRI jurisdictions. Recent research[13] shows that the existing tariff system globally has an environmental bias: On average, jurisdiction tariffs are lower on carbon-intensive industries (upstream) than on clean industries (downstream). In other words, jurisdictions have imposed less protection on dirty industries than on clean industries. The tariff differential represents an indirect carbon subsidy in trade policy and, crucially, another opportunity for BRI policy design cooperation.

Therefore, from a tax administration perspective, capacity building efforts would be substantially different depending on the policy approach adopted for the handling of so-called new environmental taxes, such as carbon taxes. Ideally, these features should be contemplated when envisioning new green tax policy design.

## 3. Traditional Challenges Faced by Tax Authorities

Overseeing the policy design of "new" taxes such as the ones discussed in this paper is almost as important as investing in the digitalization of tax administration functions and building capacity in tax administrations. The simplification of tax systems is greatly dependent on the policy approaches adopted at the national level. This is likely to become a more recurrent theme, especially as jurisdictions are increasingly made to deal with highly complex business arrangements as well as environmental considerations that were previously left untaxed.

These challenges will surface while tax administrations are still confronted with traditional challenges deriving from the administration of an already complex international tax system. The interpretation and application of allocation rules under tax treaties, the administration and negotiation of mutual agreement procedures, and transfer pricing disputes arising as a result of cross-border transactions are issues that have always required attention from tax administrations, and that are likely to continue giving rise to disputes, irrespective of the recent sophistication of taxing structures.

While digitalization of typical tax administration functions could make life easier for authorities, by easing the administrative burden and giving tax officials more time to focus on higher value activities, digital transformations are also time-consuming and cash-intensive.[14] Therefore, priorities should be set from the

13 Shapiro (2020) finds that the existing tariff system across several countries represents a global indirect subsidy to carbon emissions ranging from USD550 billion to USD800 billion per year.

14 Marcello Estevão (2021). *Why Tax Administrations Are Embracing Digital Transformation*, https://blogs.worldbank.org/voices/why-tax-administrations-are-embracing-digital-transformation#:~:text=Why%20tax%20administrations,-DECEMBER%2001%2C%202021.

start to maximize the potential for success in the automation of typical tax administration functions.

## 4. Conclusion

Tax policy development is at the heart of digital transformation going forward. As functions and processes become more digitalized, the challenge faced by tax authorities, particularly tax authorities of BRI jurisdictions, will be how to dedicate resources to obtain policy solutions that are both easy to administer, and can be coordinated with other tax administrations of BRI jurisdictions. Important decisions are on the horizon, both in terms of agreeing to the proposed global standard for income allocation to a market jurisdiction under Pillar 1 of the BEPS Project, and in terms of defining rules to address negative environmental externalities.

Blockchain applications provide both opportunities for further integration and increase in revenue collection, and challenges in identifying and capturing transactions that are mostly mediated in foreign jurisdictions. All these will pose as new issues that tax administrations will have to face going forward, with great potential for novel solutions that can expedite functions within a tax administration.

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# Enhancing Tax Administration Capacity Building in Developing Countries: A New Zealand Perspective

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***Abstract***: For developing countries, raising revenues and protecting their tax bases are more important than ever in recovering from the pandemic. As a small developed country, New Zealand endeavours to provide capacity building assistance to developing regions, especially the Pacific Islands. Assistance provided encompasses the development of core taxation systems as well as international tax matters such as the establishment of exchange of information programmes and the implementation of international tax standards. Working in partnership with international and regional organisations has proved beneficial, as demonstrated in the Pacific Initiative delivered over the last two years. Cost-effective and well-organised virtual delivery of training courses has functioned particularly well during the pandemic and will continue to feature prominently in future assistance work.

***Keywords***: Capacity building; Tax administration; Developing countries; Assistance; Efficient targeted partnership

## 1. Introduction

Governments have experienced unprecedented disruption to their finances due to the devastating impacts of the COVID-19 pandemic which now enters into its third year. Globalisation and digitalisation also show no signs of slowing down. Thus, enhancing capacity building of tax administrations in developing countries is more important than ever, in order to ensure all the citizens can raise their living standards and not fall further behind.

As a developed country and a member of the Organisation for Economic Co-operation and Development (OECD), New Zealand is committed to "making a difference" and providing capacity building assistance where possible. This article will set out New Zealand Inland

Revenue's capacity building objectives, explore some recent experience in delivery of capacity building assistance, and examine future developments.

## 2. Challenges and Opportunities

There is general recognition that the efficient collection of taxes is a vital element in improving the economic welfare of developing countries. As a relatively small country with limited resources for international capacity building, New Zealand's biggest challenge in providing assistance is how we can apply our scarce resources to achieve the best possible outcomes for developing countries while also ensuring that our own tax administration (Inland Revenue) can deliver its local program of work within various capacity constraints.

As a leading jurisdiction in the South Pacific, we are particularly cognisant of the needs of small island developing countries. We also have constitutional obligations in regard to the Cook Islands, Niue and Tokelau. Our experience over the years has taught us that:

- No "one size fits all" in providing capacity building to tax administrations in developing countries;
- Capacity building must match the needs and priorities of the target countries; and
- Capacity building is best tailored specifically to each country — we must listen and work with them rather than make broad assumptions as to their stage of development.

We have also seen considerable fragmentation in the delivery of capacity building assistance. There are several international organisations — notably the OECD, the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum), the World Bank Group (World Bank), and the International Monetary Fund (IMF) — and of course regional organisations, such as the Asian Development Bank (ADB) and the Study Group on Asian Tax Administration and Research (SGATAR), providing such assistance in the wider Pacific region, as well as individual tax administrations acting alone. This has led to a considerable duplication of efforts while at the same time not necessarily addressing the key needs of developing countries.

Further complications have arisen in the Pacific region with the European Union (EU) establishing a list of Non-Cooperative Jurisdictions and potentially linking future development funding to countries proceeding with certain information exchange initiatives and eliminating harmful tax practices, such as special tax rates and incentives. Pacific Island countries are working through various policy changes to satisfy the EU requirements.

## 3. Practice and Progress

New Zealand's main focus in providing capacity building is on the small island developing countries closest to us geographically, the Pacific Islands. Given New Zealand's limited resources, our preference in terms of both efficiency and effectiveness is to provide capacity building assistance on a one-to-many basis, especially training courses, or one-to-one short-term assistance in coordinated joint ventures. In addressing the needs of Pacific Island countries, we have separated assistance for core taxation systems from assistance in international taxation matters.

### 3.1 Core Taxation Systems

The Pacific Financial Technical Assistance Centre (PFTAC) was established in 1993 to promote macro-financial stability in Pacific Island countries through a focused programme of technical assistance and training. PFTAC was the first of the IMF regional technical assistance centres, representing a collaborative venture between the IMF, the IMF member countries in the region, and bilateral donor partners. The goal of PFTAC is to strengthen the institutional capacity of Pacific Island countries to design and implement sound macro-economic and financial policies. Macro-economic and financial stabilities, in turn, are essential underpinnings for sustainable economic growth and the achievement of sustainable development goals.

International tax measures are not the top priority for small island developing states that have more basic needs. The population bases of

most Pacific nations are very small with large numbers of people living in rural areas. Their residents do not display high wealth or incomes generally associated with offshore evasion which automatic exchanges of financial account information seek to remedy. There is also minimal activity of multinational enterprises (MNEs) in most Pacific Island countries (the major exceptions being Fiji and Papua New Guinea), often being of a basic trade supporting nature and displaying low functionality. The Pacific Island countries have very few double tax treaties (for most, none at all). Thus, complex transfer pricing, tax treaty abuse, and mutual agreement procedure issues arise infrequently compared with larger jurisdictions.

The most immediate issue for the great majority of Pacific Island countries is the development of core taxation systems. PFTAC concentrates on addressing core systems, such as registration, return filing, assessment, debt management and enforcement activities. New Zealand has always been a major donor to PFTAC, serving as the best-placed organisation "on the ground" (based out of Fiji) to deliver such targeted assistance to Pacific Island tax administrations. PFTAC assistance on core systems is provided on an ongoing basis to 16 Pacific Island countries and territories comprising 13 members of the IMF (Federated States of Micronesia, Fiji, Kiribati, Nauru, Palau, Papua New Guinea, Republic of the Marshall Islands, Samoa, Solomon Islands, Timor-Leste, Tonga, Tuvalu and Vanuatu), as well as the Cook Islands, Niue and Tokelau.

New Zealand Inland Revenue supplements the work of PFTAC on core systems by responding to specific bilateral requests from Pacific Island countries through:

- Targeted in-country assignments of experts;
- Study visits to Inland Revenue;
- The placement of personnel from Pacific Island tax administrations at Inland Revenue; and
- The provision of operational and technical manuals and training materials.

Unfortunately, the COVID-19 pandemic and consequent travel restrictions have largely put a pause on the above bilateral capacity building efforts over the last two years.

### 3.2 International Taxation Matters

As PFTAC does not cover international tax matters, Inland Revenue has assisted in filling this gap for Pacific Island countries. In this regard, New Zealand has endeavoured to provide practical training on:

- International exchanges of information, especially the use of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters;
- Meeting Base Erosion and Profit Shifting (BEPS) minimum standards; and
- Double taxation agreements, including the mutual agreement procedure.

A major turning point was reached in 2020 in terms of addressing the lack of coordination and consequent duplication of efforts mentioned earlier. The ADB brought together several international and regional organisations — OECD, Global Forum, World Bank and the Pacific Island Tax Administrators Association (PITAA) — as well as the two largest tax administrations in the South Pacific (the Australian Taxation Office and New Zealand Inland Revenue) to develop a Concept Note to provide technical assistance on international tax matters to Pacific Island countries.

In doing so, the ADB drew extensively on the learnings of New Zealand and other partners, working closely with PITAA as to the specific needs of Pacific Island countries. Particular features of the Concept Note include that:

- The development of core tax systems was recognised as the most pressing need for most Pacific Island countries;
- The Pacific Island countries were grouped into three categories according to their level of development;
- One group, comprising those countries that are placed on the EU list of Non-Cooperative Jurisdictions, was earmarked to receive greater engagement and tailored tax assistance so they could work towards satisfying the conditions required to comply with EU criteria; and

- A staged approach to capacity focuses on international tax matters, with immediate priorities being the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and practical training on exchanges of information on request.

A work plan of assistance, known as the Pacific Initiative, was subsequently developed and agreed. This programme of work has been delivered virtually over the last two years, undaunted by the travel restrictions imposed as a result of the COVID-19 pandemic. The virtual form of delivery has worked well for all concerned, not only due to its low cost but also allowing wide participation of tax administrations across the Pacific region.

Well-attended workshops have been delivered on the following, with all partners contributing to:

- Exchange of information on request (2020);
- International tax standards, risks and benefits for Pacific developing countries (2021); and
- Tax transparency related to exchange of information for tax purposes and BEPS (2022).

These joint workshops have informed and educated the participants in utilising international tax cooperation concerning tax transparency and exchange of information, powerful tools in identifying potential revenue sources, monitoring tax compliance and developing tax risk profiles. The Pacific Initiative was further enhanced when the ADB created and launched the Asia Pacific Tax Hub in May 2021. The hub provides an open and inclusive platform for strategic policy dialogue, knowledge sharing, and development coordination among ADB, its members, and development partners.

### 3.3 Support to Other Capacity Building Programmes

Beyond the Pacific Island countries, our priorities are to work in partnership with international and regional organisations. In this regard, we have worked principally with SGATAR and OECD Global Relations in providing support to their capacity building programmes by volunteering experts to offer the right assistance. As a small tax administration, Inland Revenue is able to readily identify relevant subject matter experts to provide the assistance required. Experts will be released for overseas assignments to provide all health and safety aspects that are at the very least to meet New Zealand legal standards.

Inland Revenue experts have covered a wide range of international tax topics for these capacity building programmes. Topics have included advanced transfer pricing; the mutual agreement procedure; implementation of anti-BEPS measures; the negotiation, interpretation and application of tax treaties; addressing the tax challenges of the digital economy; and the implementation of the Common Reporting Standard. All of these courses have been delivered successfully through virtual means over the last two years.

### 3.4 Supporting the Digitalisation of Tax Administrations in Developing Countries

No tax administration alone, whether large or small, has an abundance of resources available to provide at will to digitalisation projects in the developing world. Tax administrations must consider where they can truly add value and how best this can be done in partnership with others.

In this regard, New Zealand is participating along with Australia in the ADB-led Domestic Resource Mobilisation Project for the Solomon Islands, involving a new fit-for-purpose tax administration information system and organisation restructuring. Inland Revenue has agreed to provide specific assistance in governance matters by providing experts for the project steering group, and also to select the advisory firm for the project.

This is the first digitalisation project for a developing country in which New Zealand is participating, with Inland Revenue having only just completed its own major digital transformation project and organisational restructuring over the last five years. We are open to providing similar tailored assistance to other developing countries for digitalisation projects as long

as our own capacity allows, with considerable resources still committed at home to embed the new systems and related ways of working.

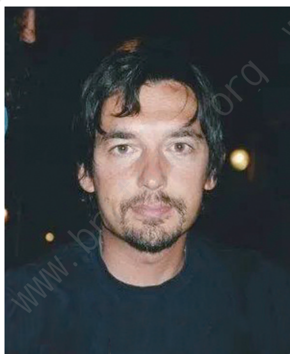
## 4. Future Outlook

New Zealand is very positive about the future of capacity building in taxation matters and Inland Revenue's role in providing this assistance to developing countries, especially Pacific Island countries. Unsurprisingly, there are numerous needs to satisfy in the developing world, but unfortunately a shortage of resources handicaps the availability to provide the assistance required. Developing countries critically depend on tax collection to fund their government operations. We are acutely aware that raising revenues and protecting their tax bases are more important than ever due to the setbacks from the pandemic and a likely slow recovery for most.

Cost-effective and well-organised virtual delivery of numerous and wide-ranging courses over the last two years has demonstrated that targeted capacity building is possible even in the most difficult circumstances. We consider our contributions are now having much greater impact through effective prioritisation, partnering with international and regional organisations, close coordination and planning. We look forward to working closely with our many international partners, including the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM) and its members, to strengthen domestic resource mobilisation in developing countries.

# Enhancing Tax Administration Capacity Building in Italy

Stefano Latini



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***Abstract***: This article focuses on the means and strategies envisaged and adopted over the years by the Italian Revenue Agency to provide excellent, agile and more taxpayer-centred services through innovation and digitalization. All these measures have been implemented to strengthen the effectiveness of tax system to guarantee a continual flux of domestic resources essential for good governance, investments, sustainable growth and stability in response to the needs of the country. In particular, due to the continuous and steady communication with taxpayers, the Italian Revenue Agency has embraced new and innovative ways to grant fair taxation and respond to changes in society. This innovative approach resulted in a full kit of accessible e-services to millions of taxpayers.

***Keywords***: Tax administration; Capacity building; Digitalization; E-services

## 1. Opportunities and Challenges in Tax Administration

Today's tax administrations are meant to be regarded by taxpayers more as partners than as one-dimensional enforcers. Particularly, tax administrations are more like business enablers that contribute to the social and economic sustainability and well-being of the nation. This remarkable transformation is well underway within the Italian Revenue Agency and is built on one of the most precious values — trust. Creating trust in the digital age is of key importance in the development of the tax fields and will reshape the role of tax administrations. That is why the Italian Revenue Agency has been tangibly addressing its activities and strategies over this path. Also, thanks to this innovative process, tax administrations are destined to turn into real and flexible suppliers capable of delivering information, contents and fiscal advice. In this field, the Italian Revenue Agency can offer a valuable and experienced model.

## 2. Practice and Progress Achieved on Tax Capacity Building in Recent Years

As governments have been struggling to respond to the enormous challenges facing societies, economies and our pla-

net, speed and agility are now essential attributes of public authorities. During the pandemic, national treasury departments, including the Italian Revenue Agency, are required to set aside traditional structures and processes in order to release huge amounts of money urgently needed to maintain social cohesion. In such a scenario, the Italian Revenue Agency has embraced new and innovative ways to grant a proper taxation in order to respond to changes in society. This big transformation, put into practice by the Italian Revenue Agency, assumes that digital technologies are replacing manual processes, producing more agile, service-driven organizations which are able to meet customers' demands for convenience, speed, and ease of use. Therefore, skilled tax operators are becoming a human resource in high demand. For this reason, the Italian Revenue Agency pays particular attention to the quality of human resources, organization, development of performance management systems, digitalization, and management of inter-institutional and stakeholder relations.

## 3. Achievements Made in Recent Years

User-centric products and services, combined with technology, have facilitated participation and, at the same time, effectiveness and quality in Italian Revenue Agency performances. Particularly, the Italian Revenue Agency made significant improvements in digitalizing tax procedures, services, administration functions, and activities. In fact, online tax returns filing has become the norm. Therefore, it is no longer a surprise that annual data shows that most parts of the tax returns for personal/corporate income and VAT are submitted online. It means that the Italian Revenue Agency rapidly reacted to the pandemic risks and built a new mostly-digital Agency model, being able to ensure a secure and efficient working framework for taxpayers and officers. This is also because the massive use of digital tools to support tax compliance was already largely accomplished.

The development of a large array of digital services also helped guarantee tax collection during the pandemic. For example, the Italian Revenue Agency makes it available for 40 million individual taxpayers to have their income tax returns already pre-filled and ready to be accepted or, if necessary, integrated with new data. The success of this tool is growing, thus making it possible that in the future almost all prepopulated tax returns will be accepted without modifications.

Moreover, since the introduction of mandatory e-invoicing from January 2019, Italian Interchange System has transmitted 5 billion electronic invoices. Whilst concerning the first year of mandatory e-invoicing, almost 4 million business operators were involved and over 4.2 million QR Code generation requests aimed at entering and using the e-invoicing system have been submitted. In the same period, approximately 4.4 million electronic addresses were registered for the receipt of electronic invoices and an average of about 200,000 daily logins to the "Invoices and Fees" portal were registered. That is the output of just 12 months of operations monitored and reported by the Revenue Agency system corresponding to billions of data sent to the Revenue Agency, worked and managed to assure optimization of services and tax enforcement activities.

In response to our stakeholders, the Revenue Agency is now able to offer a full kit of accessible e-services to millions of taxpayers. On the Revenue Agency's website, it is possible to use many services directly without any registration. For accessing certain services, it is necessary to have credentials released by the Public Digital Identity System (SPID) or a National Service Card (CNS). Taxpayers may also submit the request for a service remotely by e-mail or certified e-mail (PEC), attaching the necessary documents and indicating all references (e.g., telephone number) for any subsequent contacts. The services provided range from accessing "your own tax account" (through which it is possible to view income tax returns submitted, payments made, eventual registered leases and deeds, communications and refunds received, one's unique certifications, and the employment payments sent yearly to the Agency by tax substitutes) to entering your personal "re-

served area" that enables citizens to have a full vision of the pre-filled tax return, including payment of taxes, fees, and domestic workers contributions, submission of inheritance tax return, automatic cadastral transfer and transcription of the property (SuccessioniOnLine), and even updating of buildings and land prepared by qualified technical professionals (architects, engineers, agronomists, surveyors, building experts). We also manage a mobile App "AgenziaEntrate" as an easy and immediate multifaceted e-service tool.

## 4. Future Outlook for Tax Capacity Building

Looking into the future, the Italian Revenue Agency has already put many new prospects to achieve the agenda. The implementation of e-invoice is top on the agenda. Indeed, the adoption of the e-invoice system has reduced errors and made all the relevant processes more efficient, which makes the relations with business partners and professionals much easier, thanks to the automation and the sharing of standards and procedures. Next on the agenda, the Revenue Agency will implement the full adoption of an ambitious new VAT collection program, under which the tax administration could pre-fill VAT returns on behalf of taxpayers. This program aims to simplify the reporting and procedures of VAT documents and, at the same time, improve tax compliance. This is because pre-filled VAT forms could both simplify VAT collection for tax authorities and sharpen the ability of businesses to comply with tax duties. Furthermore, the recent launch of a new video call service, enabling taxpayers to enter into a "live" dialogue with the officials of the Revenue Agency, will contribute to enhancing tax administration capacity building.

# Recent Developments of Tax Administration in the Republic of Tajikistan

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***Abstract***: The Tax Committee under the Government of the Republic of Tajikistan (Tax Committee) regularly improves tax administration and provides quality services to legal entities, individual entrepreneurs, individuals, civil servants, government agencies and the banking sectors. Up to now, more than 60 kinds of electronic services could be accessed by taxpayers on the official website of the Tax Committee, which greatly facilitates the digitalization of tax administration and contributes to the reduction of compliance burden of taxpayers. The government has adopted and revised Tax Codes to simplify tax system, strengthen tax administration, and optimize overall tax environment. Moreover, the Tax Committee has implemented a new Tax Administration Development Program for 2020-2025 to improve the quality of activities of tax authorities, and enhance the service for taxpayers. A number of online trainings, including those initiated by the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM), are held to improve the qualification, knowledge and skills of employees of the tax authorities in the country.

***Keywords***: Capacity building; The digitalization of tax administration; Tax service

According to the World Bank research conducted in 2021, the tax administration of the Republic of Tajikistan had a significant credibility among the respondents of this research, due to the fact that the Tax Committee under the Government of the Republic of Tajikistan (Tax Committee) has improved tax administration on a regular basis and provided quality services to taxpayers.

Nowadays, taxpayers in Tajikistan, including legal entities, individual entrepreneurs, individuals, civil servants, government agencies and the banking sector, have access to more than 60 kinds of electronic services on the official website of the Tax Committee,[1] such as filing tax returns in electronic format, paying some taxes through bank cards, obtaining infor-

1 https://www.andoz.tj/.

mation from the Unified State Register, online requesting for a certificate of being registered in the inspection, checking fiscal receipts online, acquiring electronic value added tax (VAT) invoices, electronic filing of applications for VAT refunds and others.

From 2017 to 2020, taxpayer satisfaction with the official website of the Tax Committee has increased from 27.3% to 92.5%. From 2016 to 2020, taxpayer satisfaction of electronic appeals has increased from 23.8% to 68.8%, and the overall assessment of satisfaction with the electronic declaration system from 2016 to 2020 has increased from 61.5% to 97.7%. Today, more than 70% of taxpayers in the Republic of Tajikistan use the website of the Tax Committee, where all the necessary information is available for conducting business activities in the country.

Back in 2012, electronic filing of tax returns was introduced on the official website of the Tax Committee to simplify the process of filing tax returns and reduce the frequency of interaction between taxpayers and tax authorities. In addition to electronic declaration, the tax authorities have also introduced online payment of taxes, electronic marking of goods in warehouses and electronic appeals.

The digitalization of tax administration in the Republic of Tajikistan has significantly contributed to the reduction of the human factor, and remote interaction with taxpayers has largely reduced the time required for filing tax returns by taxpayers.

In order to expand non-cash payments and save as much time as possible for paying taxes and state duties, the Tax Committee introduces an electronic service that allows taxpayers to pay some taxes through bank payment cards ("Visa" and "National Card") without visiting banks.

In addition, today the specialists of the State Unitary Enterprise "Tax Administration Programming Center" of the Tax Committee have developed a mobile application "Andozi man", which allows individual entrepreneurs and individuals to carry out actions related to the fulfillment of tax obligations and beyond. A large number of electronic services of the Tax Committee are now available in this application, including "Personal Account", "TIN Search", "Tax Calculator", etc.

On 9 October 2021, the Decree of the Government of the Republic of Tajikistan (No.432) adopted a new procedure for using online cash registers and virtual cash systems for settlements with the population in order to simplify the money circulation procedure, shrink the shadow economy, expand tax base, increase cash flows through bank cards and mobile wallets, increase non-cash payments and streamline the digitalization of the tax administration system.

On 1 January 2022, a new edition of the Tax Code of the Republic of Tajikistan was put into force. Developed by an inter-departmental working group with the involvement of local and international experts, the amended Tax Code was formulated based on the experiences of other countries and the main trading partners of the Republic of Tajikistan, as well as the proposals from ministries and other state bodies, representatives of the private sector, business associations, and international financial organizations, including the World Bank Group, International Monetary Fund (IMF), and the Asian Development Bank (ADB).

One of the goals of the new edition of the Tax Code is to promote foreign direct investment, simplify the tax system, improve the quality of services to taxpayers and improve voluntary tax compliance of taxpayers. The other goals include improving tax administration, facilitating the tax collection process, reducing the administrative burden for responsible taxpayers and increasing the transparency of the tax system, so as to maintain the principles of tax fairness, legislative transparency and tax certainty, provide economic entities with equal opportunities, and eliminate contradictions and disputes.

With the adoption of the amended Tax Code, major and significant reforms will be introduced, including the preservation of some existing tax incentives and the introduction of a number of new tax incentives to create a more favorable environment for investment and entrepreneurship. In addition, the tax on road users has been excluded from the list of taxes, and the total number of taxes has been reduced from 10

to 7 types. The VAT rate has been reduced from 18% to 15% and it is envisaged that, up to 2027, the VAT rate will be reduced to 13%; the personal income tax rates (8% ~ 13%) have been abolished; and a single rate of 12% has been established.

At the same time, in the current Tax Code, for manufacturing enterprises, the income tax rate is retained at 13%; for credit and financial institutions as well as mobile companies, the rate has been reduced from 23% to 20%; and for other types of activities, the rate has been reduced from 23% to 18%. The social tax rate for insurers has been reduced from 25% to 20%.

The new edition of the Tax Code provides new provisions regarding tax control and tax administration, including:

- introduction of a system of electronic labeling of goods imported into the territory of the Republic of Tajikistan and produced in the Republic of Tajikistan, as well as marking or QR codes of excisable goods;
- use of functional currency;
- use of modern methods of prevention of tax evasion and avoidance of taxation;
- introduction of tax monitoring;
- implementation of automatic cameral control;
- voluntary registration as a VAT taxpayer; and
- other tax administration mechanisms.

Along with this, the Tax Committee plans to introduce big data technologies to search, process and store large volumes of structured and unstructured data. The use of big data in tax administration increases the transparency of tax processes. It becomes possible to track large transactions with large amount of VAT, tax refunds and cross-border transactions.

It should also be noted that the Government of the Republic of Tajikistan approved a new Tax Administration Development Program for 2020-2025 dated 30 December 2019 (No.643), which will be financed by annual budget allocations and a grant from the World Bank. The World Bank allocated USD50 million for the implementation of this six-year state program. This program will contribute to the simplification of the tax system, the improvement of the

services for taxpayers, the enhancement of the voluntary tax compliance, and the achievement of the following objectives and goals:

- improving tax administration, creating a healthy, competitive business environment and shrinking the shadow economy;
- improving steady development of the automated system of tax administration, establishing remote cooperation with taxpayers and government agencies, reducing the use of paper documents;
- improving the tax discipline of taxpayers; and
- improving the quality of activities of tax authorities.

According to the action plan "on awareness-raising" proposed by the Tax Committee, the tax authorities organized 1,781 seminars, consultations and meetings with taxpayers on such topics as the procedure for filing tax returns, the use of cash registers, the installation of POS terminals, etc., with an aim to enable taxpayers to timely pay taxes to the budget and thus improve the culture of paying taxes in 2021.

Meanwhile, in 2021, the Tax Committee, through state media, information centers, radios, magazines and newspapers, provided 773 programs, announcements, news, television commercials and explanatory magazines for citizens and taxpayers on the above-mentioned topics.

Center for capacity building of the Tax Committee conducted 34 trainings for 931 employees of the Tax Committee in 2021, in order to improve the qualifications, knowledge and skills of the tax authorities' staff. The trainings were aimed at promoting the political and legal education of employees, enhancing their professionalism and attention to issues related to gender equality, strengthening tolerance and developing human rights.

Within the framework of programs related to the use of the existing modules of the computer program — "Integrated Tax Management Information System" (ITMIS) in 2021, trainings on the procedure for filing the tax returns were also held, including the declarations of simplified regime taxes, income tax, and VAT on the electronic submission of a civil servant's income and property declaration and approval of a comparative act, on the procedure for registering and operating the taxpayer's personal account and on the use of ITMIS computer program modules, including:

- electronic treasure and tracking invoices for value added tax;
- tax accounting — individuals;
- tax accounting — legal entities;
- VAT and tracking invoices of the taxpayers;
- accounting for taxes of individuals;
- accounting by type of activity;
- tax accounting of cash registers with fiscal memory;
- management and monitoring of tax debts;
- reports of legal entities and individual entrepreneurs;
- acceptance of payments from the operator Amonatbonk; and
- the procedure for issuing non-cash invoices for bank payment cards through electronic POS-terminals, etc.

In addition, employees of the tax authorities of the Republic of Tajikistan actively participate in the online training programs organized by the Belt and Road Initiative Tax Administration Capacity Enhancement Group (BRITACEG). These programs are very useful to improve the skills of participants by learning the modern practices of tax authorities of the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM) members. To date, the employees of the central office of the Tax Committee have participated in a variety of online training programs of the BRITACEG, such as:

- resolution of tax disputes;
- services for taxpayers;
- large business management;
- digitalization of tax administration; and
- VAT reform.

In conclusion, it is worthy to reiterate that the doors of the Tax Committee are always open for a constructive and trustworthy dialogue with all taxpayers, investors and international organizations to resolve emerging issues on the correct application of the provisions of tax legislation of the Republic of Tajikistan.

# Enhancing Tax Administration Capacity Building: Macao SAR Experience

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***Abstract***: The fast pace of development in the international tax matters requires enhancement of tax administration capacity building. The outcomes of the *Final Report of the Enhancing Tax Administration Capacity Task Force* released in September 2021 confirmed the increasing demand of the BRI jurisdictions for capacity building in international taxation. This article reflects on possible areas and approaches for capacity building enhancement. It proposes some initiatives that may be developed to help address the gaps among the BRI jurisdictions and contribute to building the capacities of their tax officials. This reflection is made with a view drawn from the experience of the Macao SAR as one of the first Belt and Road Initiative tax academies.

***Keywords***: Capacity building; Tax administration; International tax; BRITA

## 1. Introduction

Enhancing the capacity building of tax administrations has become essential when dealing with international tax matters. The fast-paced development of international tax standards over the past years has led to increasing demand for capacity-building programs by tax administrations worldwide. The importance of the subject was also recognized by the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM) members, who made "Enhancing Tax Administration Capacity" one of its five Actions in the *Wuzhen Action Plan (2019-2021)*.[1] Furthermore, the acknowledgment of the increasing need for capacity building was also reflected in the *Nur-Sultan Action Plan (2022-2024)* which included "reinforcing capacity building of tax administration" as one of its core areas.[2]

1 BRITACOM (2019). *Wuzhen Action Plan (2019-2021)*, https://www.britacom.org/zchj/qwfb/202002/t20200228_1098050.html.

2 BRITACOM (2021). *Nur-Sultan Action Plan (2022-2024)*, https://www.britacom.org/gkzljxz/Documents/202109/P020210909571248238981.pdf.

Macao SAR has always acknowledged the role of the BRITACOM as a fundamental platform for tax cooperation and envisaged contributing to the enhancement of capacity building within the BRI jurisdictions. Macao SAR, one of the hosts of the first BRI tax academies (BRITAs), has started programs to provide solid training to tax officials in a multilateral environment with a focus on Portuguese-speaking jurisdictions. In this consideration, the article will share share the experiences of the BRITA· Macao as well as some thoughts on current and upcoming challenges for capacity building of tax administrations.

## 2. Challenges and Opportunities for Capacity Building of Tax Administrations

Enhancing tax administration capacity building constitutes a key aspect of achieving sustainable goals through the collection of more revenue. The enhancement of tax administration capacity building should aim at assisting tax officials in increasing knowledge and understanding the issues at stake while developing the expertise that allows them to identify and implement adequate policies and perform appropriate tax measures.[3] Another important aspect is to provide tax officials with relevant knowledge that allows them to be more involved and engaged in policy discussions at the international fora[4] and play a role in contributing to the development of international tax standards.

### 2.1 Challenges

The outcomes of the *Final Report of the Enhancing Tax Administration Capacity Task Force* (Final Report) released in September 2021 are clear but not surprising: some BRI jurisdictions are facing more challenges in achieving these goals and are therefore in more need of capacity building.[5] In fact, such jurisdictions are the ones that may play the most fundamental role in providing feedback on capacity-building needs.

The Final Report also identified the main challenges for tax administration capacity building. Given the gap between the lack of resources and the increasing demand for more knowledge, the Final Report concludes that there is a particular demand for capacity building in international tax administration, not only due to the changes in international tax standards but also because that the existing capacity building programs among the BRI jurisdictions appear to focus on their domestic tax system.[6] Furthermore, the lack of adequate time for training was also one of the shortcomings identified by the Final Report. Finally, the Final Report also identifies that training topics among the BRI jurisdictions are still confined to additional demand for international tax training to deal with the complexity of cross-border transactions and secure additional tax revenue.[7]

Based on the above, the general sense from the perspective of enhancing tax administration capacity building is that several initiatives may be developed to help address the gaps among the BRI jurisdictions and contribute to building the capacities of their tax officials. In this context, with a focus on international tax matters, different topics can be (or continue to be) of relevance for developing capacity-building programs. For instance, regarding tax treaties, interpretation and application of tax treaties, tax treaty negotiation, or the interpretation of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI) are topics in high demand.

3 UN Committee of Experts on International Cooperation in Tax Matters Twenty-third Session Capacity Building for Tax and Domestic Resource Mobilization, 11 October 2021, E/C.18/2021/CRP.37, para. 6.

4 See *supra* note 3, para. 6.

5 BRITACOM (2021). *Final Report of the Enhancing Tax Administration Capacity Task Force,* https://www.britacom.org/gkzljxz/Documents/202109/P020210927369788084979.pdf.

6 See *supra* note 5, pp. 7.

7 See *supra* note 5, pp. 8-9.

**2.1.1 Tax dispute prevention and resolution**

For tax dispute prevention and resolution, there should be a significant focus on the Mutual Agreement Procedure (MAP) and Advance Pricing Agreements (APAs). This may contribute not only to a more expedited resolution of tax disputes but also to tax certainty as a tool to foster foreign investment.

**2.1.2 Transfer pricing**

Another relevant area for capacity building is transfer pricing. Transfer pricing is certainly a classical subject for capacity building which appears to renovate a challenge for tax administrations. The Arm's Length Principle (ALP) is the reference for profit allocation which requires MNEs to set their transfer prices equivalent to those unrelated companies that would negotiate in an open market under the same facts and circumstances. But it poses significant conceptual, technical, and practical issues. In the context of searching comparable transactions for transfer pricing measurement, some BRI developing jurisdictions face even more challenges due to the limitations caused by scarce (or sometimes even non-existing) information in particular regions. Therefore, transfer pricing is an area that is increasingly in need of capacity building due to recent developments. For instance, the COVID-19 pandemic has impact on transfer pricing analysis or the role of value creation, or risk decision-making in the context of transfer pricing measurement and as a proxy for profit allocation. In addition, the hardness to value intangibles is one of the areas of significant complexity that raises challenges for tax officials in the interpretation and application of transfer pricing tasks.

**2.1.3 Digital economy**

However, there are also new topics that raise considerable challenges for enhancing capacity building. Undoubtedly, challenges posed by the digital economy are the latest. The October 2021 Statement of the OECD/G20 BEPS Inclusive Framework (IF) on a two-pillar solution to address tax challenges arising from economic digitalisation is a historical agreement that represents the most fundamental change in the international tax system in the last century.[8] It creates a new taxing right, a new nexus and new profit allocation rules for taxing digitalised transactions (Pillar 1) while setting a new global minimum tax for certain MNEs at a rate of 15% (Pillar 2). The Statement also represents the commitment by all jurisdictions that joined the agreement to remove any unilateral measures such as digital services taxes and identical measures. There is a very tight timetable for implementation which should occur by the end of 2022 so that the measures can enter into force by 2023. There is a general recognition that this timetable is ambitious in that there is high demand for simplification and fairness, especially in developing jurisdictions where there will also be a growing demand for technical assistance in terms of capacity building of their tax administrations and also legislative support for the implementation of these measures. Capacity building may be required at different levels. There is significant work for jurisdictions worldwide in learning the exact framework of the agreed two-pillar approach, requiring a significant effort for multilateral training events. There is also some support in need for jurisdictions to grasp the economic impact of both pillars. And jurisdictions will also need assistance in the implementation of the agreed rules and particularly in building tax administration capacity and analytical capabilities to ensure that the agreed framework ultimately achieves its goals.

**2.1.4 Other future challenges**

Other future challenges for capacity building may arise in areas where international taxa-

8 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-october-2021.pdf.

tion may produce guidance. One of those areas may be environmental taxation, especially carbon taxation. The carbon tax is a specific type of environmental tax, levied on carbon emissions or its proxy. This is a topic where some discussions have already been raised at international fora and therefore more awareness may need to be raised in the context of capacity building programs. The taxation of crypto-assets and virtual currencies is also a topic that has already been on the international tax agenda mostly in the context of the exchange of information for tax purposes. Several jurisdictions are planning to develop policies and regulations, and thus capacity building may be required for relevant tax officials.

## 2.2 Opportunities

The possibilities for improvement and enhancement of tax administrations are no doubt not limited to the above-mentioned topics but naturally cover a whole array of other issues. One of the issues is the duration of trainings. As the lack of adequate time of training was identified as a shortcoming in the BRI jurisdictions, extending the training hours is one of the challenges to be addressed. The way to address this issue may vary depending on the format of the trainings: online or on-site. For instance, for online training, a training course may be extended to several weeks (or months), while for on-site training, a course may have longer training hours, or several courses on different training topics could be organised throughout the year.

Another issue is to try to design capacity-building programs to address local or regional particularities. In this regard, the BRITAs have already provided a major contribution. For instance, by focusing on specific groups of jurisdictions, the BRITAs may bridge certain gaps in terms of training languages or regional realities, thus making the capacity-building programs more targeted.

Finally, the BRITACOM may also play a significant role as a platform for merging experiences between developed and developing jurisdictions. One of the areas that capacity building may improve is the possibility of developed jurisdictions sharing their knowledge and experience with developing jurisdictions. Developing jurisdictions may benefit not only from financial, technical and human resources of developed jurisdictions but also from their experience in dealing with taxpayers. This kind of

knowledge could provide valuable support for developing jurisdictions, allowing them to acquire a more proper understanding on the issues and challenges on specific topics.

## 3. Practice and Progress Achieved by Macao SAR

The practice and progress achieved by Macao SAR in terms of capacity building may be interesting, since it plays a dual role both as a recipient of capacity building for its tax officials and also a provider of capacity building programs under the framework of the BRITA·Macao.

The Financial Services Bureau of Macao SAR has long attached great importance to the knowledge-based learning and continuous education of its staff, to ensure that they are duly qualified to better perform their duties. Therefore, a variety of training programs are offered with the training needed by the assigned staff. In the context of international tax matters, participation in the trainings can be on-site with the goal to have access to the best knowledge that equips the staff to cope with global tax challenges. Due to the COVID-19 pandemic, staff continued attending relevant trainings online. Occasionally, staff who attended overseas courses on international tax knowledge may offer internal training courses on what they have learned overseas.

From the perspective of risk management and tax governance, the Financial Services Bureau has recognised the importance that both the tax officials and the taxpayers should acquire knowledge on the relevant tax matters. In other words, proper understanding and application of the legislation may require capacity building for taxpayers as well. Therefore, the Financial Services Bureau has organised public sessions, inviting relevant stakeholders or the public in general to explain the newly introduced legislation, regulations, or amendments to the application framework. The purpose of these sessions is to inform taxpayers and institutions that are more directly involved in the application of relevant legislation about the newly introduced framework and amendments by explaining its goals, purposes, and functions as well as clarifying any existing questions about the meaning and application of the legislation at stake.

In the context of providing capacity-building programs, the BRITA·Macao is one of the four tax training institutions (BRITA·Yangzhou, Beijing, Nur-Sultan, and Macao) established to date under the framework of the Belt and Road Initiative Tax Administration Capacity Enhancement Group (BRITACEG). The BRITA·Macao operates alongside the Financial Services Bureau and is primarily devised on enhancing capacity building with Portuguese-speaking jurisdictions. The BRITA·Macao has been providing training in a multilateral environment to serve as a platform for tax officials to share views and experiences and exchange ideas since its inception. In line with the *Nur-Sultan Action Plan (2022-2024)*, BRITA·Macao has issued certificates to participants upon their successful completion of the training programs.

The planned courses of the BRITA·Macao had to be adjusted due to the COVID-19 pandemic. Originally, the courses were scheduled to be on-site in specific premises, yet they had to be turned to an online format. Rather than

having the whole course delivered through online live sessions, a decision was made to adopt video courses. This decision was made for two reasons. First, participants, potentially from four continents, are in different time zones, making it almost impossible to find a time convenient for everyone. Second, the video courses have become a common and successful practice in some of the most reputable academic institutions with extensive experience in delivering online programs, and it has also been a success model tried by other international organisations.

The first two courses delivered by the BRITA·Macao gathered significant interest from the participants of Portuguese-speaking jurisdictions. The first course was dedicated to the topic of "Prevention and Resolution of Cross-Border Tax Disputes". It was a natural choice to set tax dispute prevention and resolution as the first course of the BRITA·Macao. First, the preliminary results of the surveys conducted under the task force on enhancing tax administration capacity building already demonstrated that there was a need to increase programs on this topic.[9] Second, there was already the expectation of an increase in tax disputes following the implementation of the OECD/G20 BEPS Action Plan.

The second course was dedicated to addressing the tax challenges of the digitalised economy. The course was very well received. It was delivered between December 2021 and January 2022 which was believed to be a timely course considering the two-pillar approach Agreement in the October 2021 Statement of the OECD/G20 BEPS IF.

Meanwhile, more courses are planned for 2022, which will continue to be delivered in an online format.

Certainly, one of the biggest challenges of these initial years of the BRITA·Macao has been the ongoing need to adapt to the COVID-19 circumstances. It is fair to say that online training is lack of interaction and engagement which on-site training easily provides. However, online training has proven to have some positive results. It expands the BRITACOM's influence and contributes to a significant saving of costs for tax administrations.[10] Furthermore, it expands the number of participants as it allows more tax officials of each tax administration to attend these courses to which they might otherwise not be able to attend in person. Finally, it also provides some flexibility for capacity-building programs. Considering the outcomes achieved by online courses, it may be considered that, in the future, courses should be delivered in a hybrid format (both on-site and online) to accommodate tax officials with different preferences.

## 4. Future Outlook for Tax Capacity Building

The demand for capacity building among the BRI jurisdictions is increasing; therefore, the BRITACOM and the BRITAs could play a fundamental role. Following the *Nur-Sultan Action Plan (2022-2024)*, there should be an enhancement of tax administration capacity building. In this regard, there should be a continuous effort to improve the training quality, choose the most appropriate topics based on the needs of the BRI jurisdictions as well as use the approach and methodology that allow achieving the best results. The tax developments, particularly in the international tax area, will increase the demand for capacity building, thus calling for a global effort in developing the best tools to enhance capacity building of tax administrations.

The BRITA·Macao remains entirely aligned with the *Nur-Sultan Action Plan (2022-2024)*, and will continue to make best efforts to comply with its mission and the goals of the BRITACOM to bolster training and deliver top-notch courses to tax administrations.

9 This was confirmed in the final report which revealed the need to increase the programs on tax dispute resolution by at least 5%. See the Report *supra* note 5, pp. 8.

10 See the Report *supra* note 5, pp. 11.

# Talent Cultivation for Advancing Tax Modernization: Recent Developments in China*

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## 1. Introduction

The Chinese Government has prioritized talent building in its overall national governance. At a central conference on talent-related work in September 2021, Chinese President Xi Jinping stressed that efforts be made to implement the strategy on developing a quality workforce in the new era and to speed up China's upgrade toward a major world center of talent and innovation. Focus will be put on cultivation, attraction and good use of people with talent.

The State Taxation Administration of China (STA) attaches great importance to talent cultivation. The STA Commissioner Wang Jun has proposed the construction of a large tax talent pool with excellent caliber, constantly optimized structure and increasingly functional importance.

With relentless efforts, China's tax administration has basically established a pyramid-shaped talent system to advance tax modernization as a result of the initiation of the "Talent Nurturing Project", which features Strategic Talents, Elite Tax Talents, Professional Talents, and Proficient Talents as the main body, complemented by expatriate talents, young talents, and those in brain banks.

## 2. Overview of China's Tax Talent System

The STA respects the law of talent development, and pursues a systemic approach in talent pool building. Further-

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more, the STA follows the guiding principle of "selection, cultivation, management, and utilization" to nurture talents and form the main framework of talent system with taxation characteristics.

### 2.1 Adhere to Strict Standards of Talent Selection

The STA applies the procedure of "pre-admission + learning ability assessment + work ability assessment + comprehensive evaluation" to screen Elite Tax Talents, adopts "on-the-job contest" to select professional and proficient talents, and devises the means of "bottom-up selection + organization recommendation" to choose young talents. Talents are selected based on integrity, experience, and competence.

### 2.2 Formulate Best-laid Plans of Talent Nurturing

The STA develops tiered plans and carries out intensive training programs to help various categories of talents update concepts, upgrade theory, gain knowledge, and harness skills in assorted fields in a well-conceived way. A wide range of textbooks, courses, programs, and question banks have been published, and the Learn4Tax online learning platform has been launched, integrating the learning, training and tests.

### 2.3 Employ Digital System of Talent Management

The STA, leveraging the information system of Digital Human Resources, has created personal growth accounts for every tax official to record details of their learning, training, practices, daily performance, etc. The Elite Tax Talents will be trained in a progressive and targeted manner, and will be sent in batches to work at the frontiers of tax reform and innovation in tough areas. Meanwhile, the warning and elimination mechanism management is strictly implemented for Elite Tax Talents.

### 2.4 Multiple Channels to Make the Utmost of Talents

The STA expands channels and builds an effective mechanism to make good use of talents, tap their full potentials, and encourage their development by preferment, appointment, promotion, lateral transition, and accreditation abroad. The STA analyzes individual experience and growth, designs targeted training plans, and directly fosters designated grassroots talents above a certain rank. In this way, the career goals of tax officials are aligned with the general direction of tax reform and development. All competent staff can undertake key tasks and major research topics of the STA and its provincial branches, and outstanding talents are tempered at the frontiers of reform, on strenuous posts, and in tough areas.

At the same time, the STA builds an organizational guarantee system that is dynamic, efficient, more open and conducive to talent development, so as to form a new pattern of talent work with unified leadership of the STA, close cooperation between the personnel department and relevant departments, firm support from tax administrations at all levels, and extensive participation of social forces.

## 3. Practice of China's Tax Talent Building

### 3.1 Snapshot

Talents are the primary resources. The STA, focusing on the general goal of tax modernization in the new era, vigorously implements the strategy of promoting taxation with talents to formulate the development plan of talents in the national tax system, constructs the "Talent Nurturing Project" and promotes the "1115 Project" of talent echelon, and fully leverages the Learn4Tax online learning platform to comprehensively improve talent caliber. Based on the "Talent Nurturing Project" and in light of actual conditions, local tax authorities continue to take innovative measures to increase the number of tax talents and make talent structure more coherent.

### 3.2 Main Parts of the "Talent Nurturing Project"

The "Talent Nurturing Project" creates a closed-loop growth mechanism of "careful se-

lection, fine nurture, strict management, and best use" and establishes a channel for development featuring "competition and growth at all levels" to build the "1115 Project" of talent echelon, that is, the talent team composed of 100 Strategic Talents, 1,000 Elite Tax Talents, 10,000 Professional Talents, and 50,000 Proficient Talents, and supplemented by expatriate talents, young talents and those in brain banks (see Table 1).

**3.2.1 Pyramid Spire: 100 Strategic Talents**

The STA proposes the Pyramid Spire Plan to select 100 first-class tax officials who have already completed the training of Elite Tax Talents Program and cultivate them into strategic talents to respond to the call of taxation cause.

3.2.1.1 Design training program

The STA has issued guiding documents to promote the cultivation of strategic tax talents, which put forward clear requirements on the goals, paths and methods of cultivation, and selected a group of tax officials with excellent comprehensive caliber, universal recognition, and enormous potential, and put them in the training program.

3.2.1.2 Offer customized training

Those covered in the Pyramid Spire Plan will be trained in different models: international and comprehensive. The former focuses on training strategic talents with international vision, proficient in foreign languages, well-versed in international rules, and experienced in international affairs. The latter aims to foster talents with strategic and innovative thinking, and big-picture awareness.

3.2.1.3 Provide practice opportunities

Those in the international oriented will be stationed in Chinese embassies and consulates abroad or international organizations, or sent to study in overseas universities, in order to expand their horizons and stimulate international thinking. Those in the comprehensive group will be dispatched or seconded to ministries and

**Table 1: "1115 Project" of talent echelon**

| Talents | Targeted Numbers | Objectives |
|---|---|---|
| Strategic Talents | Around 100 | First-class versatile talents with firm professional integrity, high caliber and singular vision |
| Elite Tax Talents | Around 1,000 | Top-notch talents with excellent comprehensive caliber, outstanding competence, and team-leading role, pioneers and pillars vital to advancing tax modernization |
| Professional Talents | Around 10,000 | Talents working in various business lines and good at solving problems, as an important guarantee for key tax endeavors and tax modernization |
| Proficient Talents | Around 50,000 | Talents with outstanding work ability in various positions, as an important force for the full implementation of the functional roles of taxation and improvement of work in different fields |

commissions of the central government, local governments and their integrated departments, and state-owned enterprises, etc., so as to equip them with strategic and innovative thinking, big-picture awareness, and the ability to deal with convoluted situations.

**3.2.2 Pyramid Body: 1,000 Elite Tax Talents**

The STA attaches great importance to the cultivation of Elite Tax Talents, and regards it as the leading program for talent workforce building. In September 2013, the STA launched the Elite Tax Talents Program to cultivate a team of high-end tax officials with international vision, strategic thinking, great integrity, and extraordinary ability, who are proficient in business and good at management with a leading role in modernization. For nearly nine years, the STA has selected more than 847 Elite Tax Talents in seven batches, subjected them to a four-year training program in three stages, and trodden a scientific path of fostering high-caliber talents.

3.2.2.1 Apply strict standards

The STA has gradually raised the threshold of application for Elite Tax Talents Program and implemented the systematic selection procedure of "pre-admission + learning ability assessment + work ability assessment + comprehensive evaluation", raising the admission threshold to screening out unqualified candidates.

3.2.2.2 Intensify training

Programs are centered on latest decisions and deployments of China's government on taxation. Meanwhile, general education is carried out by topic and professional abilities are improved by stages, highlighting intensive and frequent teaching and interaction to enhance the professional quality of those Elite Tax Talents. In general, programs are designed to meet the needs of work on the ground.

3.2.2.3 Highlight practice

The STA analyzes work experience and training orientation on individual basis, aligns career paths with key endeavors of the STA, and sends Elite Tax Talents in batches in order to work at the frontiers of reform and innovation and in tough areas. Tax authorities at every level will assume the responsibility to help Elite Tax Talents make well-directed improvement.

3.2.2.4 Perform stringent management

Enforcing high standards and strict requirements, the STA assigns different responsibilities to provincial tax services and work organizations of qualified candidates and assesses the performance of provincial branches in the evaluation system. Each candidate will have a director-general level official as their mentor to supervise and instruct them when appropriate and necessary. The close one-to-one relationship will give full play to the mentors' guiding role in candidates' research and development. A regular management mechanism of candidates after their completion of the project will be established to carry out comprehensive judgment and follow-up evaluation of them.

3.2.2.5 Strengthen accurate assessment

Committed to objectivity and fairness and focusing on work performance, the STA devises an assessment and evaluation system that combines daily assessment, academic year assessment and completion assessment, unifies quantitative indicators and process evaluation, and matches assessment results with incentives and constraints, so as to improve the quality and efficiency of the management of Elite Tax Talents.

3.2.2.6 Diversify ways of promotion and appointment

Six ways of using Elite Tax Talents including promotion, lateral appointment, rank elevation, post exchange, expatriation and strategic cultivation were clarified, and tax administrations at all levels should make flexible use of outstanding talents. Elite Tax Talents have been promoted at different levels, which has set up a good employment orientation among the majority of tax officials.

**3.2.3 Pyramid Base: 10,000 Professional Talents and 50,000 Proficient Talents**

Since 2016, the STA has launched an industry-wide "on-the-job contest" to motivate tax officials to master policies, gain expertise and enhance professional skills. In 2016, the contest was held in five areas: administrative work, tax-

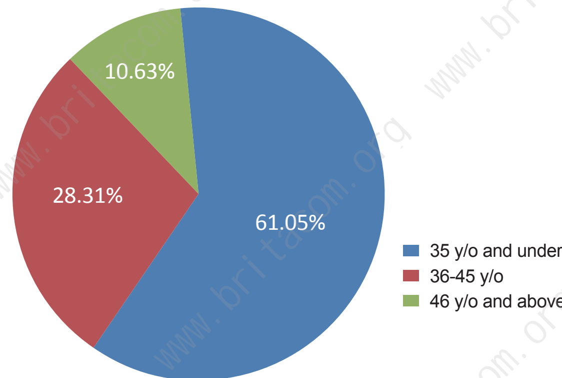


Figure 1. Age distribution

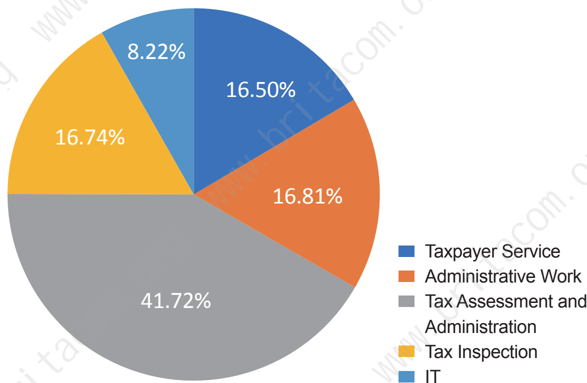


Figure 2. Work fields

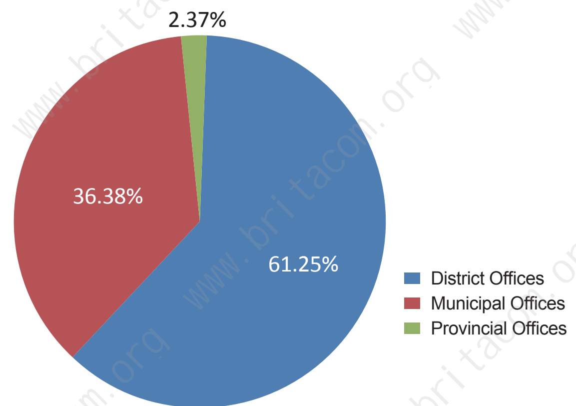


Figure 3. Organizational structure

payer services, tax assessment and administration, tax inspection, and information technology. In 2017, tax officials from sections of tax service management, tax service halls, and 12366 call centers competed in the contest. In 2018, an online contest themed "new organizations, new responsibilities, new businesses and new endeavors" was held. Through the contest for 37 posts in five fields, more than 10,000 professional talents and over 50,000 proficient talents have been singled out. The STA has managed to train a group of tax officials with excellent business proficiency for fair law enforcement and standardized service, and provided intellectual support and talents guarantee to the modernization of tax governance.

Statistics show that more and more young people have been selected as Professional Talents and Proficient Talents (see Figure 1), covering all work fields (see Figure 2), and presenting a tiered talent structure (see Figure 3).

## 3.3 Complementation of the "Talent Nurturing Project"

### 3.3.1 Expatriate Talents

For years, the STA has made relentless efforts to build a team of international talents. Since 2016, a total of 103 outstanding tax officials have been dispatched to work abroad via various channels in all the major economies. While working and studying overseas, they learn from advanced international practices, share Chinese experience, and present their views on Chinese taxation.

### 3.3.2 Young talents

Tax administrations at all levels have facilitated the growth and development of outstanding young officials with high personal qualities, out-

standing performance and great potential, and sent them to work at the frontiers of reform and in tough areas. Among the 5,270 young talents, 82.13% are under the age of 35, more than 30% have a master's degree or above, and 36% hold the Certificate of Certified Public Accountant (CPA) and the Qualification Certificate of Tax Advisor (QCTA) or have passed the Bar Exam. This young and vigorous team with tremendous potential is a dynamic force to the development of taxation in the future.

**3.3.3 Talents in brain banks**

As an effective vehicle for pooling, integrating, reserving and optimizing talents, the three-level brain banks of the STA, provincial tax services, and municipal tax services covering all kinds of professionals have served as a big stage for talents to pursue endeavors. As of now, the STA has set up 24 professional brain banks with 4,256 personnel. The three-level brain banks have not only improved the caliber of tax officials, but also advanced key undertakings of taxation, forming an effective supplement to talent teams of the STA.

### 3.4 Digital Transformation of Nurturing Talents

**3.4.1 Learn4Tax online learning platform**

Learn4Tax is an online learning platform for all Chinese tax officials, integrating learning, training, testing and other functions. In 2019, the STA identified the development trend of digital learning and launched the construction of the Learn4Tax platform. In 2020, the platform was officially promoted across tax services nationwide. At present, the platform has become a new place for learning, a new stage for training, and a new leverage for capacity building.

The Learn4Tax platform boasts 10 learning areas ("Taxation Lectures" area, Elite Tax Talents Training, among others), 26 channels, and 4 hot-issue columns. By the end of 2021, recorded lectures in the "Taxation Lectures" area have been watched more than 3.973 million times. In the column of "Morning Podcast", 100 morning meeting videos have been released and watched for 983,000 times in total. The "Morning Podcast" timely presents the latest tax policies, work priorities, operation steps and precautions to the frontline staff of tax service, which helps to improve the relevance and effectiveness of training for staff in tax service halls, by increasing their capacity and providing strong support for the establishment of the new tax service system.

By the end of 2021, there were nearly 700,000 registered users on the Platform, with an average daily traffic of 102,000 visits on weekdays throughout the year, which stimulated the innovation and upgrading of education and training. The Platform has gradually transformed into a routine, digital and practical learning site. In terms of routine learning, in accordance with the overall goal of "daily learning, learning by working, routine testing, result accumulation, and assessment for reference", the STA has explored and formed a complete mechanism of "study, test, and assessment", combining the Platform with Digital Human Resources system and performance management, boosted tax officials' learning and practice in daily life, and galvanized their motivation of self-learning. Primary-level tax officials wittily refer to the Platform as a "gas station" on fingertips and a "charging pile" of learning. In terms of digital learning, the Platform has given full play to its underpinning and spurring role, realized the digital integration, joint contribution and sharing of high-quality learning resources, and developed a new training model of "online and offline learning" to enable everyone to learn anytime and anywhere. In terms of practical learning, adhering to the demand-oriented principle, the STA piloted the "four-in-one" new training model featuring online learning, offline training, practical training, and stock-taking in Hunan and Shenzhen Tax Services to cultivate a team of high-caliber professional tax talents in a more targeted manner.

**3.4.2 Digitization: digital human resources system**

Over the past few years, the STA has explored to adopt a digital appraisal mechanism,

gradually applied an assessment method of taxation in nature, and created the system of digital management of tax officials. Digital Human Resources system refers to the digital assessment and evaluation system established by the STA according to the rules of assessment, evaluation and daily management by the central government and based on the concept and method of big data.

The Digital Human Resources system was proposed in 2014 and put into full use in July 2019. It mainly includes: One Foundation, Four Pillars, One Roof, and One Platform, just like building a house. The "One Foundation" refers to career foundation of both veteran and fledgling personnel. The "Four Pillars" consist of Regular Assessments (Daily Performance) — record and assessment of daily performance; Peer Evaluation — internal and external assessment of tax officials' competence, diligence, performance, and integrity; Professional Abilities Evaluation — abilities in five fields, i.e., administrative work, taxpayer service, tax assessment and administration, tax inspection, and IT, further divided into 11 levels and linked to the standards of promotion; and Leadership Competency Evaluation — quantitative assessment of a leader's work performance, public recognition, pre-promotion evaluation, probationary management, audit of economic responsibility, and off-office inspection, as well as leadership competence tests. The "One Platform" is the software platform to generate, store, and analyze data. The "One Roof" stands for the Digital Human Resources system which classifies and sorts the massive data according to organizations, positions and other parameters to provide important reference for promoting, assessing and evaluating tax officials.

## 4. Achievements of Tax Talent Nurturing

With the concerted efforts of tax administrations at all levels, the number and capacity of tax talents have increased significantly, the stage and platform for endeavor and innovation have been broadened, and tax officials have been further energized. More and more talents are emerging. By the end of 2021, the total number of Strategic Talents, Elite Tax Talents, Professional Talents, and Proficient Talents has exceeded 60,000, accounting for 8.7% of all on-the-job tax officials. Talents are increasingly performing exemplary roles. The STA advocates helping others in daily work and assuming responsibilities in crucial tasks to raise the enterprising and aspirant spirit. Between 2012 and 2020, the proportion of officials with master's degree or above in tax services has increased from 3.96 percent to 8.44 percent. The number of tax officials holding CPA or the QCTA, or passing the Bar Exam jumped from 32,000 to 52,000, an increase of 62.5%. Tax officials are expanding their influences. Over the years, the STA has entrusted 453 Elite Tax Talents with different tasks, and more than 100 have won various provincial and ministerial-level commendations and honorary titles.

The implementation of the strategy of rejuvenating tax by talents has improved the overall quality of the talent team, provided talent guarantee for the smooth implementation of major tax administration reforms in recent years, and laid a solid talent foundation for further promoting tax modernization.

Firstly, talents have undertaken their mission and maximized their value while focusing on the top priority to serve the development of taxation. They have played their indispensable roles both in implementing major decisions and deployments, such as the replacement of business tax with VAT, the large-scale tax and fee reductions, the integration of national and local tax services and large scale tax reimbursement, and in executing major development strategies for serving the country's regional coordinated development and high-level opening up to the outside world. For example, various tax talents have assumed their responsibilities and overcome difficulties in delivering tax and fee cuts of more than RMB7.6 trillion from 2016 to 2020; over 15,000 tax officials have contributed to poverty alleviation across the country, fully demonstrating the commitment and dedication of the iron-clad army of taxation; more than

10,000 professional and proficient tax officials have based themselves in the grass-root level communities and established task forces in playing their leading and exemplary role to improve taxpayer services.

Secondly, tax officials have shouldered their responsibilities in deepening tax reform and enhancing the effectiveness of governance. They have made substantial contribution in promoting tax reform to increase the role of tax in serving the national and social governance. Among Elite Tax Talents, as per number of participation, there are 372 directly involved in the institutional reform of integrating national and local tax services, and 191 involved in 47 major missions, including the reform of PIT and the reform of IT-based special invoices for VAT. In the same vein, for proficient talents, 2,300 of them have taken on the special work of the STA, and 3,413 have carried out key tasks of the Golden Tax Project Phase III, tax inspections, and evaluations of tax administration. All kinds of talents have played their courageous and exemplary roles in removing impediments in major reforms, and have obtained experience in fulfilling urgent, difficult, dangerous and arduous tasks in strenuous positions.

Thirdly, tax officials have presented a positive image in serving the opening up and participating in global governance. All kinds of tax talents actively serve the national strategy of opening up to the outside world, contributed their parts to global tax governance, and played an increasingly eminent role in international tax arena. Since 2016, 103 high-end talents have been stationed in 58 countries and regions across 6 continents, and 23 Elite Tax Talents have been working actively in major events of international taxation such as the Belt and Road Initiative Tax Administration Cooperation Forum (BRITACOF) and the OECD conferences and negotiations on tax issues arising from digital economy. In addition, some Elite Tax Talents have given lectures at the Belt and Road Initiative Tax Academy to help developing countries improve their tax administration capacity and participate in international tax governance.

## 5. Next Steps

Going forward, steps should be taken in the following aspects to strengthen talent nurturing so as to enhance the capacity of tax governance in China.

Firstly, expand the scale of talent workforce. The STA will continue to follow the demand-oriented philosophy, adopt more active, open and effective measures to steadily and orderly expand the talent workforce, and attract high-end and urgently-needed talents to meet the needs of tax modernization in the new development stage.

Secondly, improve the caliber of talents. The STA will continue to enhance the caliber of talents, and focus on cultivating strategic, elite, professional, and proficient talents in different fields and at various levels to guarantee diverse aspects of taxation, and further cultivate a top-notch team that meets the needs of tax reform and development.

Thirdly, explore new ways for talent management. The STA will overthrow obsolete ways and establish a new system for better talent training, and maintain, adjust, and strengthen it when appropriate. The information of tax talents is collected on individual basis and used to advise tax authorities at all levels on selecting and appointing talents, so that the capability of every tax official can be turned to good account.

Fourthly, make breakthroughs in talent utilization. The STA will further reinforce the cultivation and utilization of outstanding talents, transform the potential advantages of tax officials into practical abilities, promote them to fully display their personal aptitudes, and continuously create a favorable situation where able men are coming forward in multitudes and give full scope to their faculties. Domestic and international exchanges will be strengthened to promote cooperation with relevant countries and international organizations on talent and technology projects as well as exchange of professional and technical personnel, and to provide technical and intellectual support to the cultivation of international tax talents.

# Kazakhstan's Practice in Improving Tax Environment:

## An Exclusive Interview with Chairman Ali Sapargaliyevich Altynbayev, SRC, Kazakhstan

In recent years, Kazakhstan has made great progress in the ease of doing business. By reducing tax burden in order to support the development of entrepreneurship in the Republic of Kazakhstan and simplifying tax administration procedures for business entities, tax authorities are constantly working to ensure the timely and high-quality fulfillment by taxpayers of their tax obligations in accordance with tax laws and regulations. Against this backdrop, the correspondents from the *Belt and Road Initiative Tax Journal* (BRITJ) interviewed Mr. Ali Sapargaliyevich Altynbayev, Chairman of the State Revenue Committee of Ministry of Finance of Kazakhstan (SRC).

**BRITJ: Mr. Chairman, thank you for being with us in this interview. Would you please introduce the major changes to tax legislation and administration, and their impact on improving tax environment in your country?**

**Ali Sapargaliyevich Altynbayev:** It's a great pleasure to be with you for this interview. Tax legislation is a sphere of law, and its norms are constantly improved. Most of the changes to tax legislation have already been in effect from 1 January 2022, and some will come into effect in the near to medium term.

Here I'd like to highlight some specific changes in Kazakhstan. First, tangible state support is provided to small and micro businesses, for example, a certain category of entrepreneurs is exempt from income taxes and tax audits for three years.

Second, individual entrepreneurs and legal entities (small business entities) have the right to choose only one of the following procedures for calculating and paying taxes and submitting tax reports:

- the generally established procedure;
- the special tax regime based on a patent;
- the special tax regime based on a simplified declaration; and
- other procedures.

For Kazakhstani entrepreneurs, the regime based on a simplified declaration is considered to be the simplest and most convenient. The regime involves minimizing accounting procedures and ease of preparation and submission of reports, thus allowing taxpayers to file a tax return without an accountant, especially for the sole proprietors who do not have any employees.

Special tax regimes are simplified mechanism of tax payment established by the Tax Code of the Republic of Kazakhstan. There are special tax regimes for small businesses, producers of agricultural and aquacultural products, agricultural cooperatives, as well as for peasants or farms.

**BRITJ: Besides the changes in legislation and administration, what measures has Kazakhstan taken to promote tax digitalization? And what are the effects of these measures?**

**Ali Sapargaliyevich Altynbayev:** In Kazakhstan, digital technologies are being introduced in tax and customs administration in order to create a favorable tax environment for taxpayers engaged in both domestic and foreign economic activities, minimize human factors in decision-making, create effective mechanisms to scale down the shadow economy and ensure adequate tax revenues for the state budget.

Roadmaps on optimization of public services have been approved by the interdepartmental commission, which is committed to the further optimization and automation of the e-government portal, as well as the integration of the public and private sectors.

The vision of human-centricity lies at the heart of the digitalization initiative of the tax and customs administrations, which is aimed at creating the most favorable conditions for citizens. To this end, alternative digital solutions have been put in place by the tax and customs administrations. For example, in parallel with the Taxpayer's Office, free mobile applications E-salyq-Azamat and E-salyq-Business are designed for the convenience of fulfilling tax obligations by taxpayers while reducing their time and financial costs. These mobile applications allow taxpayers to automatically calculate taxes

and social payments, pay taxes, and receive a tax notification and/or certificate online, prefill tax returns and simplify declaration, etc.

As a result of the work carried out by the Ministry of Finance, it is planned to increase the provision of public services in electronic format to 95% by 2025.

From year to year, systematic work is being carried out to reduce budget classification codes and optimize tax returns. Since 2015, the number of codes of budget classifications has been reduced by 2.5 times, and tax returns have been optimized by 30%.

**BRITJ: We're especially interested in the program "Digital Kazakhstan" launched in 2017. Could you please give us an overview of this program?**

**Ali Sapargaliyevich Altynbayev:** The State Program "Digital Kazakhstan" was approved by the Decree of the Government of the Republic of Kazakhstan No. 827 on 2 December 2017, which is designed to accelerate the pace of the economic development and improve the living quality of our citizens. The program is aimed at developing digital technologies in key sectors of the country. Improving the quality and quantity of online public services will help reduce bureaucracy and corruption, and make government agencies more efficient and open.

Digitalization of the interaction between the state and businesses is intended to reduce the transaction costs of entrepreneurs, and increase the transparency of decisions made by state bodies and organizations. A significant direction is to implement a set of measures aimed at improving the quality of tax and customs administration. The increase in tax revenues is also achieved by integrating databases of various sources. Facilitating access to preferential financing and reducing or eliminating certain types of taxes for e-commerce players will also help enhance the competitiveness of entrepreneurs doing business online.

**BRITJ: As we have learnt, the Digital Kazakhstan program was updated in 2020. Is there any new progress in tax administration?**

**Ali Sapargaliyevich Altynbayev:** In December 2021, the Law on Amendments to the Tax Code was promulgated. Thus, starting from January 2022, a new form of state control over the traceability of circulated goods has been introduced.

In addition, the list of risk criteria has been removed from the Tax Code, and will be regulated by a by-law instead, in order to simplify both the procedure of making changes to the list and the risk management system itself.

The simplified liquidation procedure is applicable not only to persons who are not VAT payers, but also to VAT payers who, according to tax reporting data, have not carried out business activities from the date of VAT registration.

The following list of information that banks and banking organizations must provide to the tax authorities has been expanded:

- Information on the total mobile payments received by companies and individual entrepreneurs for the calendar year (Effective from 1 March 2022);
- Information on monthly payments to the accounts of individual entrepreneurs applying special tax regimes and using a special mobile application (Effective from 1 March 2022);
- Information on payments and transfers made in favor of foreign Internet companies for the calendar year; and

- Information on transactions that have signs of receiving income from business activities via accounts of individuals who are not entrepreneurs (Information should be provided for those who are obliged to declare income. Therefore, this provision is being introduced in line with the stages of the universal declaration).

Also, from 1 January 2022, the statutory limitation period for all large businesses is five years. For a number of large companies, this means that, in 2022, the tax authorities may review their tax liabilities since 2017. Previously, the total limitation period for a tax obligation and claim had been reduced from five to three years since 1 January 2020.

**BRITJ: We understand that the "Electronic Invoice Information System" has proved to be the most effective measure in digital tax administration in Kazakhstan. Could you tell us more about the system?**

**Ali Sapargaliyevich Altynbayev:** The most effective tool in remote administration was the introduction of the "Electronic Invoice Information System", which allows taxpayers to track all transactions on goods and services, and at the same time, check the completeness of their income.

The system works online. Since the launch of the system (in 2016, on a voluntary basis, and in 2019, mandatory application to all VAT payers), over 814 million invoices have been issued, with about 771,000 taxpayers being registered on the system.

The SRC also carries out automatic desk control with the system. Due to the use of the Risk Management System, the analytical programs and information resources, violations, such as firms that issue fictitious invoices, are detected remotely with notifications. However, taxpayers are given the opportunity to make self-corrections. As a result, the efficiency of desk control has been enhanced, and tax revenues have been increased without going to the audit stages.

**BRITJ: It is universally acknowledged that blockchain is a popular technology nowadays. Kazakhstan has made some exploration in administering VAT with the blockchain technologies. Could you please share some views on the use of blockchain technology in your tax administration?**

**Ali Sapargaliyevich Altynbayev:** Yes, the blockchain technology protects the data while making it more accessible and transparent. However, it is important to comply with the legal requirements of a particular state when using the data stored in the blockchain, such as the General Data Protection Regulation (GDPR) of the EU.

Work has been underway to explore the feasibility of introducing the blockchain

technology in VAT administration and setting up funds on the technical implementation of the relevant project.

According to the results of the work carried out, taking into account the positions of the National Chamber of Entrepreneurs of the Republic of Kazakhstan "Atameken", the Association of Taxpayers of Kazakhstan, and the banking sector, without the mandatory use of a control account by all VAT payers, the introduction of blockchain technology in VAT administration will be ineffective, which will entail risks for the budget.

The Ministry of Finance of the Republic of Kazakhstan, by letter No. 001-KG/10946-I dated 29 April 2021, submitted a position to the Office of the Prime Minister (KPM) of the Republic of Kazakhstan on the inexpediency of introducing blockchain technology in the VAT administration and spending funds on the technical implementation of the relevant project.

According to the results of the meeting dated 12 May 2021, the position of the Ministry of Finance of the Republic of Kazakhstan on the inexpediency of introducing blockchain technology in VAT administration was supported by the Administration of the President of the Republic of Kazakhstan. According to the resolution of the Head of the Presidential Administration of the Republic of Kazakhstan, E. Koshanov, dated 25 May 2021 No. 6584 PUB-8, as well as the instructions of the KPM of the Republic of Kazakhstan dated 27 May 2021 No.20-2/04-426//20-01-7.7(2.6-T.), item 42 of the State Program "Digital Kazakhstan" regarding the administration of VAT using block-

chain technology was removed from control and from 1 January 2022 excluded from the Tax Code.

**BRITJ: Is there any other new progress in VAT administration?**

**Ali Sapargaliyevich Altynbayev:** According to the Law of the Republic of Kazakhstan (No. 85-VII ZRK), dated 20 December 2021, amendments were made to the Tax Code (effective from 1 January 2022) in terms of extending the VAT payment on imported goods by the offset method for the means of production which are absent in the territory of the Republic of Kazakhstan until 1 January 2025, as well as excluding pesticides, breeding animals of all types and equipment for artificial insemination and live cattle from the list of imported goods, for which VAT is paid by the offset method. Action exemptions for VAT payment by the offset method have been extended until 1 January 2025, which simplifies procedures of registration and closure for sole proprietors, as well as submission of tax reports, and exempts bank commission and payment for services of operators of fiscal data.

Business entities (according to the List) that converted at least 50% of the foreign exchange earnings received from the export of raw materials for the tax period are entitled to apply a simplified manner for VAT refund (no more than 80% of the amount of excess VAT established for the reporting tax period).

To simplify tax administration, goods traceability systems, accompanying invoices for goods and electronic seals are being introduced, which will ensure transparency of implementation between counterparties.

**BRITJ: Does the SRC have any other plans to optimize the tax environment in the future?**

**Ali Sapargaliyevich Altynbayev:** Kazakhstan faces a challenging task to achieve sustainable, balanced, and "green" growth. The Republic is striving to get into the top 30 most-developed countries in the world by the middle of the century. To meet that goal, we are working hard to achieve the transition from a resource-oriented economy to a cleaner, innovative and diversified one, which requires improving the public administration system, and increasing the openness and competitiveness of the economy. Tax authorities should tap the potential new data technology in tax administration and maintain constant communication with taxpayers, and provide taxpayers with tailored tax services. With the introduction of modern information technologies, the tax authorities will make every effort to expand the scope of taxpayer services, improve the quality of services, and monitor the implementation of tax rules, so as to ensure effective compliance with tax laws and regulations, transparency of economic activities, timely and complete collection of tax revenues, as well as improvement in the quality of budget planning and stability of state revenue.

Specifically, methodological basis for optimizing expenditures of the republican and local budgets will be developed; the information system of state planning regarding the use of the Single Window Procurement service will be finalized; a new scheme for providing vehicles will be developed; monitoring and control of the effectiveness of the use of anti-crisis funds will be strengthened; and an analysis of the effectiveness of state support measures will be carried out.

# The BEPS 2.0 Era Dawns: Five Long-term Implications for Belt and Road Jurisdictions

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***Abstract***: The OECD/G20 Inclusive Framework (IF) on Base Erosion and Profit Shifting (BEPS) has substantially finalized the model rules and much of the guidance for the so-called "Pillar 2" global minimum tax, while work continues on the so-called "Pillar 1" new taxing rights for market jurisdictions. As many BRI jurisdictions are among the 141 IF members, there is value in starting to consider the long-term implications of the new global tax system, and the extent to which the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM), through the four core work areas of the *Nur-Sultan Action Plan (2022-2024)*, can contribute to ensuring that BRI jurisdictions manage the transition for maximum benefit.

***Keywords***: BEPS; Pillar 1; Pillar 2; BRITACOM; Subsidies; Tax incentives; Tax transparency

## 1. Introduction

On 14 March 2022, the OECD/G20 Inclusive Framework (IF) on Base Erosion and Profit Shifting (BEPS) released Commentary on the model rules for a global minimum tax. The model rules had been released shortly before, in December 2021. Termed the Global Anti-Base Erosion (GloBE) rules, these rules are the core element of "Pillar 2" of the two-pillar solution to address the tax challenges arising from the digitalization of the economy. An IF statement, setting out the core elements of this solution, was agreed by over 135 IF members on 8 October 2021.

The GloBE Commentary, which is a final document, released at the same time as a public consultation, was commenced on the administrative aspects of the rules, the GloBE Implementation Framework. Like all other aspects of the two-pillar solution, this framework is set to be finalized later this year, thus completing the most significant refresh of global tax rules in 100 years. The IF members, at time of writing, are persisting with a highly ambitious target effective date of January 2023 for most of the key rules, though there is an increasing sense that January 2024 may be more realistic for many jurisdictions.

The Belt and Road Initiative (BRI) jurisdictions, in the main, did not play a central role in creating current international tax system in the 1920s. However, there are many BRI jurisdictions among the 141 IF members, which have played an important role in shaping the new international tax system. While some aspects of the rules are still being set, particularly in relation to the new market jurisdiction taxing rights in Pillar 1, this is a good time to start to consider the long-term implications of the new system for BRI jurisdictions. To this end, we explore five key impact areas:

- Move to formulaic profit allocations;
- Subsidies vs. tax incentives;
- "Next level" tax transparency;
- Tax base harmonization; and
- Tax administrative "culture shock".

In the final section of this article, we conclude that the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM), through the four core work areas of the *Nur-Sultan Action Plan (2022-2024)*, will have a crucial role to play in ensuring that BRI jurisdictions manage the transition to the new global tax framework, and draw maximum benefit from them. Firstly, to set the scene, we chart out the key elements of the global agreement and the next steps on this journey.

## 2. Key Elements of the Two-Pillar Solution

As noted above, the key global political agreement thus far has been the IF statement of 8 October 2021. This included agreement on the key elements of the two Pillars, a work program for the finalization of the detailed rules in 2022, and targeted implementation dates for IF jurisdictions in 2023 and 2024. To give context for the five long-term implications detailed further below, we provide a high-level summary of Pillar 1 and Pillar 2.

### 2.1 Pillar 1

Pillar 1 is the part of the program which has been the longest in development. It is a reaction to the frustration expressed by many jurisdictions on their inability to tax. In a digitalizing era, many jurisdictions could not tax foreign enterprises which interact/transact intensively with their market and consumer base, but have no physical presence (branch or subsidiary) in their jurisdiction. Nearly a decade in development, starting with the original BEPS 1.0 project, the Pillar 1 rules (specifically the so-called Amount A rules) grant a market jurisdiction new taxing rights over a foreign enterprise with reference to revenue "sourced" to that jurisdiction. Taxing rights are granted regardless of whether the foreign enterprise has a local physical presence or not. In addition to breaking with the 100-year international tax norm of linking taxing rights ("nexus") to physical presence, the rules also involve further major shifts. This includes treating entire MNE groups as single economic units, rather than dealing with MNE constituent entities one-by-one (the "entity approach"), and by allocating profits to jurisdictions using

formulaic approaches rather than traditional "facts and circumstances"-based transfer pricing (TP) rules. The IF is still working on the Pillar 1 rules and is releasing rule models as "building blocks" for consultation. This is with a view to finalizing them, and an implementing multilateral convention (MLC), for signature in summer 2022.

#### 2.1.1 Scope

MNEs with worldwide revenue greater than EUR20 billion and profitability above 10% (return on sales) are in scope. From the MNE profits in excess of 10% ("residual profits"), 25% is allocated to markets under formulary rules ("Amount A"). Between 100 and 150 MNEs would initially be in scope and this number would more than double after 7 years when the revenue threshold falls to EUR10 billion. Revenue from extractive industry and regulated financial services activities is excluded.

#### 2.1.2 Revenue sourcing and nexus

Detailed sourcing rules are set out for numerous categories of income. Businesses need to build systems which can reliably and consistently use the permitted indicators and allocation keys to source the revenue to countries (the basis for formulary allocation to jurisdictions). Coupled with this is a nexus threshold to determine whether a jurisdiction, to which revenue is sourced, has a taxing right in the first instance. This is set at EUR250,000 locally sourced revenue for jurisdictions with less than EUR40 billion in GDP, so being relevant for many smaller BRI jurisdictions, and EUR1 million above that.

#### 2.1.3 Safe harbor and elimination of double tax

Where the residual profits of an in-scope group are considered to be already taxed in a market jurisdiction, a marketing and distribution profits safe harbor (MDPSH) will cap the residual profits allocated to the market jurisdiction through Amount A. While the design is yet to be finalized it appears that the MDPSH might be a combination of a fixed market return for baseline activities plus Amount A. This MDPSH should be compared with the TP-determined return of local subsidiaries and branches; only where there is excess over the TP return will Amount A allocations be made to the market jurisdiction. This is paralleled by rules to determine who "foots the bill" for Amount A, i.e., which country grants double tax relief. Indications with that much of burden will land with hub locations like Ireland and Singapore, as well as headquarter jurisdictions.

#### 2.1.4 Tax certainty and unilateral measures rollback

IF jurisdictions will be subject to mandatory binding dispute prevention and resolution mechanisms both (i) for Amount A, and (ii) for issues related to Amount A. The latter covers TP and PE disputes which alter the profit allocations that are referenced when making the Amount A allocations (e.g., the profits booked to a Singapore hub company that grants double tax relief). While the relevant building block is yet to be released, earlier releases indicated that both mechanisms would include a review panel (to attempt to reach a negotiated resolution between countries) followed by a determination panel (a deadlock-breaker with voting on several possible outcomes by tax experts). The tax certainty mechanisms to buttress the new market taxing rights are to be paralleled by a rollback of digital service taxes (DSTs) by jurisdictions that have introduced them, and a commitment not to introduce any new such measures in future.

Pillar 1 also involves an effort to streamline the application of transfer pricing to marketing and distribution activities (Amount B), focusing particularly on the needs of low-capacity countries. Earlier ideas included potential use of fixed returns for some in-scope activities, though precisely how ambitious and far-reaching the rules will be remains to be seen later in 2022.

### 2.2 Pillar 2

Pillar 2 is the part of the program which has generated most excitement (and concern). As a later addition to the global tax reform program, Pillar 2 emerged into public consciousness in 2019. The goal is deceptively simple — to ensure that large MNEs pay a minimum level of tax (15%) on the income arising in each jurisdiction in which they operate. However,

this is underpinned by calculations and taxing mechanisms of fierce complexity, demanding that tax officials, taxpayers and tax advisors all "up their game" significantly. It impacts on a broader range of MNEs than Pillar 1, estimated to be over 5,000. It is also likely to have significant spillover effects on how countries design their domestic tax systems. With the release of the Commentary, there are already 350 pages of highly granular rules and guidance set on GloBE, with further guidance forthcoming under the GloBE Implementation Framework.

**2.2.1 Scope**

The GloBE Rules are to apply to MNEs with revenues exceeding EUR750 million. However, countries remain free to apply the IIR to MNEs headquartered in their countries whose revenue falls below this threshold, and some have already publicly indicated this intent (e.g., India). Exclusions are limited to certain government entities and investment and pension funds. How wide the effect of the rules may be remains a question. While MNE consolidated financial statements (CFS) are the kick-off point for applying the rules, a deeming rule would appear to draw in collections of entities under common control that do not prepare CFS.

**2.2.2 Three interlocking rules**

GloBE includes an Income Inclusion Rule (IIR), which imposes top-up tax on a parent entity in respect of low taxed income of constituent entities within an MNE group. It also includes a supporting Undertaxed Payment Rule (UTPR) under which the jurisdiction of another group entity can deny tax deductions (or impose an equivalent tax adjustment) to the extent the low taxed income of a constituent entity is not subject to tax under an IIR. In an important addition to the final rules, the IF established that a qualified domestic minimum tax would "trump" both the IIR and UTPR, giving a low tax jurisdiction the option to "take the money", rather than allow another jurisdiction to do so. Increasing number of jurisdictions are already "raising their hands" to say this is their planned approach, and some commentators are starting to speculate that domestic minimum taxes could well be the primary mechanism through which GloBE tax is collected in practice.

**2.2.3 Top-up tax calculation**

The heart of the rules, and the most complex aspect, is the determination of the quantum of top-up tax for each jurisdiction, and each MNE group entity. The top-up tax rate is the difference between the jurisdictional effective tax rate (ETR) and the 15% global minimum rate. Faced with the diversity of tax base determinations across jurisdictions, the IF decided to use income per IFRS accounting standards as their kick-off point. This provides an ETR denominator. A common definition of "covered taxes" provides the ETR numerator. This bland description does not do credit to the complexity this generates. Applying the rules demands that financial accounting be prepared and used in ways not envisaged in the past, requiring extensive retooling of MNE accounting and tax systems. Features intended to ensure smooth operation of the rules, such as inclusion of deferred tax numbers in covered taxes to limit ETR volatility, demand creation of entire new record keeping systems.

**2.2.4 Limiting impact on routine activities**

A key feature of the top-up tax determination is that the tax base, to which the top-up tax rate is applied, is reduced by a formulaic substance-based income exclusion. This is a mark-up on the carrying value of tangible assets (8%, tapering to 5% over 10 years) and payroll (10%, tapering to 5% over 10 years) which is intended to reflect the return on routine business activities. In addition, there is an exclusion from UTPR for groups with limited overseas operations, having less than EUR50 million of tangible assets outside the home country and five or less foreign subsidiaries.

**2.2.5 Loose ends**

Despite the volume of paper generated so far with the GloBE rules, various key questions remain to be resolved. It needs to be determined whether US GILTI can be treated as a "qualified IIR" and under what circumstances. At present it seems most likely that, until such time as the US succeeds in adjusting GILTI to a country-by-country blended rule (from current

global blending) and raising the rate to 15%, GILTI is likely not to be treated as "qualified". This has significant implications for US MNEs and for jurisdictions, including in the BRI, where they have operations. In addition, MNEs are hoping that the huge compliance workload implicit in GloBE will be reduced via safe harbors (e.g., based on CbCR data) which allow them to limit work on full ETR calculations to a small number of operating countries. Myriad other matters also await clarification including the content of the GloBE Information Return, measures to resolve disputes, and the processes to determine whether IIRs, UTPR, and domestic minimum taxes, are qualified.

Pillar 2 also involves a special source country tax on interest, royalties and other (likely defined service) payments where they are taxed at less than 9%. This new treaty provision, termed the subject to tax rule (STTR), is still a work in progress.

## 3. Five Long-term Implications of BEPS 2.0

With the architecture of the BEPS 2.0 rules now outlined, we now turn to our thoughts on the possible implications for the longer term.

### 3.1 Move to Formulaic Profit Allocations

On the surface of it, just a sliver of profits is allocated to market jurisdictions under Pillar 1. As some critics have put it, market jurisdictions get "a percentage of a percentage", i.e., 25% of the excess MNE profits over 10%, and just in relation to 100+ MNEs. What is more, with the application of the MDPSH it may in many cases be determined that no Amount A allocations are due to a market, on the basis that the appropriate market share of the MNE "super profits" are viewed as "already" being booked in the market under TP rules. As such, the bulk of an in-scope MNEs profits (i.e., all profits up to 10% return on turnover and 75% of super profits) will continue to be allocated using TP methods, rising to 100% of MNE profits to the extent the MDPSH falls beneath existing market TP allocations.

However, this analysis greatly underplays the historic significance of Pillar 1. In the course of setting our existing system of international tax rules in the 1920s and early 1930s, US tax expert Mitchell B. Carroll's studies for the League of Nations played a pivotal role. Led by his work, the League of Nations work on profit attribution ultimately settled on a separate entity-driven approach to MNE profit attribution (the entity approach). This was to be based on separate accounts and driven by adherence to the arm's length principle.[1] It meant that the division of taxing rights between countries became a function of MNE internal accounting, and this had the notable advantage of treating what could be a thorny political issue, if dealt with explicitly, as a purely technical matter for accounting (and later TP) experts. Clearly negotiation and political compromise between countries (such as in the context of bilateral APAs) has always played a role, with TP "science" providing more of a framework within which negotiations occur, but Pillar 1 now "pulls off the band-aid" and explicitly treats profit allocation between jurisdictions openly as a matter of political compromise.

With this as context, we may see a more pervasive effect from the Pillar 1 shift to formulaic profit allocations that what is admitted

1 While Carroll's work focused on the attribution of profits between head offices and local PEs (ultimately Article 7 of the OECD MTC), the conclusions drawn strongly influenced TP guidance for transactions between MNE subsidiaries and parents (Article 9). See M.B. Carroll, Taxation of Foreign and National Enterprises, Vol. IV Methods of Allocating Taxable Income (League of Nations 1933). See also Section 4.1.2 of Chapter 4, C. Turley, D. Chamberlain & M. Petriccione (2017). *A New Dawn for the International Tax System*. IBFD.

to at present. For example, suppose an in-scope MNE calculates that its MDPSH falls beneath many of its existing market TP allocations and will continue to do so over many years. It could well be that the MNE decides to alter its TP policies and target the booking of profits in its markets at a level reflective of the MDPSH outcomes (i.e., reduce TP allocations to markets in line with Amount A formulaic allocations).

While tax authorities could of course contest this, further considerations come into play. At present, TP administrative approaches and outcomes diverge significantly across jurisdictions, but the mandatory binding dispute resolution process for TP issues could drive convergence. Particularly where a country pushes a TP approach at odds with global TP norms (as represented by the OECD/UN TP guidance), their tax authority may think twice about pushing on this matter in front of a panel of countries. Indeed, one conceivable outcome is that countries come to accept the MDPSH as an acceptable measure of where profit allocations should "land".

Looking beyond this, could the use of metrics based on MDPSH guide allocations for more MNEs, beyond the in-scope MNEs? In short, might countries come to accept a "drift to formulaic"? Could experience with this (including fixed returns under Amount B, if agreed) drive, over time, a return to the IF negotiating table for an even more wholesale move to formulaic? In the context of a future international tax system, with the MNE group as the central focus for formulaic allocations, might our historic (and current) entity approach with facts and circumstances TP allocations come to be viewed as "quaint"? It remains to be seen what happens in the longer term, but there are certainly many commentators who take the view that Amount A is the world's first step on the "road to formulaic".

### 3.2 Subsidies vs. Tax Incentives

One of the most discussed points in relation to Pillar 2 is the impact on tax incentives. At first blush, incentive regimes that offer rates lower than 15% may lose their appeal, as the value of these incentives may be clawed back under the IIR or UTPR. Furthermore, where an incentive regime reduces the tax rate imposed on certain income received from overseas, the STTR may kick in. As explored further below, there are features of the GloBE rules that should allow the value of incentives to be preserved in many cases. That being said, it is conceivable that incentive regimes may see greater conformance across jurisdictions, and that incentive regime rates may come to cluster in the 10%~15% range. The question then becomes, how do jurisdictions differentiate themselves as optimal locations for investment?

In this regard, there are growing calls to replace tax incentives with subsidies and grants. The advantage of subsidies is that these increase the ETR denominator (typically treated as income for financial accounting purposes) rather than reducing the ETR numerator (as is the case for tax incentives). Consequently, while subsidies will lower a recipient entity's ETR (and potentially create some GloBE tax exposure), the effect is diminished. Subsidies have no relevance to an STTR determination. As such, countries such as Switzerland and Singapore have already been reported to be examining how they might use various subsidies in future, whether straight out cash grants or reductions in enterprise income tax, personal income tax, social security contribution or VAT burdens.

It should be noted though that the GloBE rules would treat straight compensation (with subsidies or other financial support) of a specific MNE for lost CIT benefits, as compromising the "qualified" status of the relevant jurisdiction's IIR, UTPR, or domestic minimum tax regimes. Such subsidy schemes therefore need to be crafted as generally applicable.

### 3.3 "Next Level" Tax Transparency

The past decade has seen significant global efforts to raise tax transparency, including Common Reporting Standard (CRS), Country-by-Country Reporting (CbCR), mandatory disclosure requirements for tax advisors, reporting by digital platforms on traders and service providers, and beneficial ownership registers. BEPS 2.0 brings this to the next level.

- The "Big Picture" of MNE operations: The Master File and CbCR under BEPS 1.0 Action 13 provided tax authorities with an enhanced picture of how an MNE group functioned as a whole. The Pillar 1 and 2 filings will provide an even greater level of insight. For example, for companies in the scope of Pillar 1, the tax authorities will receive a complete "map" of where an MNE's products and services end up being consumed, cutting through the numerous third parties that make part of the ecosystem that any major MNE builds around itself. Apart from the value this brings for CIT enforcement, these insights could well feed into the future design of other taxes, e.g., sourcing rules for VAT purposes.
- MNE data quality and consistency: The high complexity of the BEPS 2.0 rules has led the OECD to build in a reliance on MNE accounting and tax systems. As long as an MNE can show their systems to be reliable and robust, with guaranteed high quality and consistent outputs, direct tax authority scrutiny (and associated compliance costs) may be lessened. For Pillar 1, where the MNE can show the multi-country review panel that its systems reliably apply the revenue sourcing indicators, for future years limited filings with the parent entity's tax authority will suffice. If not, then the MNE will need to return year after year to the full review panel, and also face penalties for deficient systems. With regard to Pillar 2, the Commentary indicates that so long as the data underpinnings for a utilized safe harbor (e.g., CBCR data) is robust, the safe harbor can be enjoyed. Where the data is dubious, full ETR calculations will be needed. In view of this, tax authorities will be given significant insight on the systems used by MNEs, and greater comfort on the quality of their data.

### 3.4 Tax Base Harmonization

It is often said that the impetus for Pillar 2 was the frustration of Germany and France with their lack of progress over 20 years in pushing an EU-wide minimum tax and uniform tax base calculation. This was continually blocked by other EU countries under the unanimity requirements for EU tax directives. This reading of the events of the past three years suggests that Germany and France decided that the best way to finally achieve their goals in Europe would be to get global agreement on the approach, at which stage EU opponents would have to back down. Whether this is a fair reading of events or not, the fact remains that through Pillar 2 the Germans and French have now succeeded

in a way they never did with the EU common consolidated corporate tax base (CCCTB). But what might this mean for global CIT base harmonization?

On the surface of it, the GloBE rules are simply "souped up" CFC rules (at least the IIR wing of the rules). CFC rules have existed in various countries since the 1960s without perceivably driving any harmonization in tax base determinations across countries. However, GloBE is different. Under GloBE, the ETR in every jurisdiction is calculated with reference to IFRS, or equivalent accounting standard. This contrasts with CFC rules which used the tax base rules of the MNE parent country. Secondly, CFC rules were often quite loosely applied by countries, with significant exclusions in the rules, e.g., for active business activities. This reflected a reluctance by home countries to hobble their MNEs in a competitive global landscape. UTPR, as a backstop rule, is a potential gamechanger by stepping in wherever IIR enforcement is lacking. This disciplines parent jurisdictions in their application in their use of the IIR in a way that was never true of CFC rules.

Beyond this, jurisdictions that are looking to preserve the value of incentives are presented with the same set of considerations. These may well drive countries to take similar tax policy responses, resulting in a closer approximation of tax regimes.

- As noted above, the substance-based income exclusion reduces the "excess profits" exposed to top-up tax. This has the potential to protect the value of incentives which are linked to routine manufacturing activity, which generates modest profits. For example, incentives granted to a Malaysian manufacturing subsidiary of an MNE with a cost-plus based profit may be protected. However, by contrast, the profitable Singapore treasury centre of a global bank may see less protection for its incentives, as the modest mark-up of the substance-based income exclusion on its assets and payroll may be insufficient to reduce its excess profits to zero.
- A second factor is jurisdictional blending. This means that where there is a mix of high tax and low tax income within an entity, or within entities in the same jurisdiction, the top-up tax rate may rise above 15%. With blending, incentives can still be effective. To return to our example above, the global bank may also have, alongside its incentivized Singapore treasury centre, a higher taxed Singapore branch of its global headquarters for regional lending, and Singapore based asset leasing activities. This potentially allows for use of jurisdictional blending to protect the treasury centre incentive.
- A third consideration is that the GloBE rules are "kinder" to some types of preferential tax treatment. For example, where an entity lowers its tax paid via accelerated tax depreciation this would, at first blush, lower its ETR. However, the GloBE rules allow the deferred tax liability, generated by the temporary difference between the tax treatment and accounting treatment, to be included in the ETR numerator. This would potentially bring the ETR back above 15% meaning that no top-up tax payable. By contrast, bonus tax depreciation (i.e., a permanent book-tax difference) would not be adjusted in the ETR numerator. Other tax regime features treated "kindly" by GloBE include refundable tax credits, and deductions for employee stock schemes and pension contributions. Looking forward, preferential GloBE treatments for certain items may inform the design of jurisdictional tax rules, as explored further below.

In view of these rule features, some commentators envisage that following implementation of the GloBE rules, minimum tax rates in many jurisdictions may settle somewhere around 10%. Once the substance-based income exclusion, jurisdictional blending and preferential GloBE treatments are taken into account, this may prove to be a sustainable rate. As best results may be achieved by conforming the local tax base towards the GloBE income calculation, tax base conformance across jurisdictions is a possible outcome.

It is also possible that many jurisdictions may look to retain their existing incentive regimes, but with an "overlay" of a qualified domestic minimum tax. This would preserve the value of existing tax incentives for enterprises not within the scope of GloBE, but still pick up any GloBE top-up tax, otherwise taxable by other jurisdictions. It has been suggested that one of the safe harbors, to be developed in coming months, could reference the existence of a qualified domestic minimum tax in a jurisdiction, excusing an MNE from a requirement to prepare detailed ETR calculations for such jurisdiction. Obtaining "qualified" status would require the domestic minimum tax to conform entirely to the GloBE ETR calculation, including the base.

A key matter to watch going forward will be how many countries choose to apply the IIR rules to MNEs with revenue below EUR750 million. While some investee jurisdictions might think it is best to solely apply the domestic minimum tax to local companies within groups with revenue above EUR750 million (on the basis that solely these are impacted by GloBE), this would not hold if many jurisdictions use a lower threshold. Investee jurisdictions, contending with GloBE and STTR (which appears unlikely to have a group revenue threshold), may conclude that more generalized adaptation of their tax system is preferable to a domestic minimum tax.

As a final point, one might observe that the use of IFRS as a basis for the rules has remarkable influence on the IASB, the global body that sets IFRS rules. Given the impact of changes to IFRS standards that would have on national tax revenues, will their decisions become scrutinized and politicized in a manner not seen in the past? All remains to be seen.

### 3.5 Tax Administrative "Culture Shock"

As the final "impact area" covered in this article, it cannot go without saying that the roll out of the BEPS 2.0 rules may well have a profound effect on tax administration. We would go so far as to say this might amount to a "culture shock" and may be of notable impact in many BRI jurisdictions.

There is great variety across the legal and administrative traditions and practices of different jurisdictions, including in the tax space.

- Some jurisdictions maintain highly detailed and specific tax codes, running to tens of thousands of pages. These rules are intended to deal with tax questions at a high level of granularity, and may be applied in the context of a litigious legal culture, in which tax authority-taxpayer disputes are frequently referred to tax tribunals and courts, in turn giving rise to copious court-generated legal interpretations.
- Other jurisdictions use briefer, more "directional" tax laws, leaving greater discretion to the tax authority dealing with the specific taxpayer matter. This may be accompanied to a greater or lesser degree by publicized tax authority interpretations of the rules, which may also vary in the level of their specificity. Resolution of tax disputes may rely more on negotiation than on formal court review processes.
- The drafting of the BEPS 2.0 rules might be regarded as leaning more towards the former approach. Given that a uniform application of the rules across jurisdictions is needed for the rules to operate properly, this is perhaps the only way. However, the use of hundreds of pages of legislation and guidance, at an extremely precise level of detail, will be a massive change for tax authorities in many jurisdictions, including in many BRI jurisdictions.
- How will this be dealt with? Might need a greater centralization of tax administration to deal with the companies in scope of these highly detailed rules?
- Will tensions emerge when differences in interpretation are no longer "smoothed over" through negotiation, but rather referred directly into mandatory and binding dispute resolution processes at international level? Will the example of larger groups disputing tax authority determinations through the BEPS mechanisms embolden

other taxpayers to resort to domestic appeal mechanisms with greater frequency?
- How will this affect tax authority decisions on which companies to pursue for tax audit?
- Might decisions made in connection with BEPS 2.0 in-scope companies (e.g., a dispute panel resolution determination that withholding tax (WHT) cannot be applied to certain outbound service payments) have spillover effects on the taxation of companies not in scope of the rules?
- Might the highly granular nature of the BEPS 2.0 rules have an impact on the drafting of other tax rules in the long run?

## 4. Considerations for BRITACOM

The BEPS 2.0 tax reforms have profound implications for BRI jurisdictions. Apart from the significant work involved in implementing the BEPS 2.0 rules into domestic law and tax treaties, and work to update tax authority systems and retrain officials, there will undoubtedly be spillover effects on the design of local incentives and other features of domestic tax regimes. As noted above, we may see a greater conformance in the design of BRI jurisdiction tax systems with each other over time.

BRITACOM clearly has a leading role to play in relation to this adaptation. Indeed, the action areas under the *Nur-Sultan Action Plan (2022-2024)* are particularly suited to this task.

### 4.1 Move to Formulaic Profit Allocations

BRI jurisdictions are highly diverse, including highly advanced as well as developing economies. However, a common point is that, looking ahead, their markets will become ever more significant sources of global demand as their economic integration and upgrading progresses. As such, BRI jurisdictions will need to consider how to manage the tax administrative challenges associated with making Amount A formulaic profit allocations to markets. The administrative groundwork laid in coming years will become even more important in future when the scope threshold is lowered to EUR10 billion, and even more of global corporate profit pools become subject to formulaic allocation to markets. Amongst the many challenges raised by Amount A, particularly notable is the reconciliation of Amount A allocations to TP allocations. Indeed, it is for this very reason that the IF has invested so many efforts into developing their Amount A tax certainty processes. In order to navigate this new framework and obtain appropriate results, BRI jurisdictions will need to develop further expertise and capabilities to engage with these processes, which build to a great degree on existing TP MAP processes (and are an extension of them in the case of review and determination panels for issues related to Amount A). It is in this context that BRITACOM's action on "Raising Tax Certainty" will likely make a crucial contribution, share expertise and experience, and facilitate BRI jurisdictions to engage with these processes, ensuring that Amount A works for them. Such transferred expertise may be similarly important for BRI jurisdictions' application of Amount B.

### 4.2 Subsidies vs. Tax Incentives

As with other IF jurisdictions, BRI jurisdictions will need to reconsider the optimal balance between subsidies and tax incentives for attracting the right kind of foreign investment to support their economic development. In the past, countries will often have worked on the assumption that any benefit granted, whether by way of tax relief or grant, would automatically go to the bottom line of the recipient business, and be of appeal to them. Post-GloBE, this will no longer hold, with tailored grants and subsidies potentially having greater appeal than tax incentives of the same quantum. However, by contrast, there may be cases where tax incentives give the better effect (in view of various aspects of the GloBE rules) while certain forms of grants could trigger disqualification of the jurisdiction's GloBE rules, leading to negative business environment effects. Structuring such policies will become increasingly complex, and in this context, the BRITACOM action on "Improving Tax Environment" will take on a heightened significance for BRI jurisdictions, sharing policy mix design experience for maximum effect.

### 4.3 "Next Level" Tax Transparency

With BEPS 2.0, BRI jurisdictions will have access to greater data and insights on MNE operations affecting them than ever before. However, the data management challenges will become even greater. BRI tax administrations will face questions of how they can effectively utilize this new flood of data for tax enforcement, while ensuring that the data is kept secure and confidentiality commitments met (much of which will be received from exchange with other countries). Against this backdrop, the BRITACOM action on "Promoting Tax Administration Digitalization" will play an outsize role, by transmitting best practices and expertise on data system building and management.

### 4.4 Tax Base Harmonization

As noted above, the Pillar 2 rules may well set in motion an international dynamic that results in greater convergence, or approximation, of tax bases across jurisdictions, along with widespread adoption of domestic minimum taxes. Within this dynamic, jurisdictions will face complex policy choices on areas of convergence that may help them improve their investment attractiveness, and others of lesser benefit to them. They will need to consider both the nature of MNE business operations currently deployed in their jurisdiction (e.g., capital and labor intensive) and the future aspired — to direction of travel with their economic and sectoral mix. Transmission of best practices and leading thought leadership in the context of the BRITACOM action on "Improving Tax Environment" will play an important role in helping BRI jurisdictions make the right choices.

### 4.5 Tax Administrative "Culture Shock"

Many BRI jurisdictions apply tax rules which are more concise and "directional" in their drafting and so the "culture shock" of the highly granular and detailed BEPS 2.0 rules may be particularly pronounced amongst tax officials and taxpayers in these jurisdictions. Multiple BRI tax policymakers and officials will be thus facing, at the same time, the questions highlighted above, e.g., the need for greater tax administrative centralization, influence on tax rule drafting, impact on audit and appeals processes, and spillover effects of determinations on BEPS 2.0 rules application. While all of the BRITACOM work areas may well have relevance to addressing these issues, the action on "Reinforcing Capacity Building of Tax Administration" is likely to have a particular resonance.

The next years are set to be full of intense activities in the tax space for officials, advisors and businesses as the BEPS 2.0 rules are rolled out and bedded down. In this context, the BRITACOM and its action plan have never been more important.

# Preparing for Pillars One and Two: How Tax Administrations Can Get Ahead of the Game

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***Abstract:*** Implementing and complying with the requirements of the OECD/G20 Inclusive Framework's Two-Pillar solution presents enormous practical challenges for taxpayers and tax administrations. Not least of these is a complex data challenge with over 120 data points needed for Pillar 2 alone. To tackle these effectively, tax administrations should work with each other, and with taxpayers, to develop a coordinated approach drawing on the concept of Cooperative compliance. Such an approach should aim to reduce the administrative burden, increase certainty, and provide a joint learning curve for tax administrations and taxpayers. Developing the right data systems and training people to work with the data will take time and need to start now; if businesses and tax administrations wait until all the rules and regulations have been finalised, it will be too late. In addition, the Pillar 2 Model Rules do not provide for a multilateral mechanism to determine and allocate the top-up tax. The Belt and Road Initiative jurisdictions could consider working together to develop a binding mechanism to allocate the top-up tax between themselves.

***Keywords:*** Pillar 2; Pillar 1; Tax administration; Tax certainty; Cooperative compliance

## 1. Challenges for Tax Administrations in the Age of Digitalisation

Tax administrations have core responsibilities that will never change, namely levying and collecting taxes.[1] Nevertheless, administrations need to evolve to respond to the changing environment in which they operate. The OECD describes this evolution and provides further insight into how tax administrations are:

- enhancing their technological capabilities to serve their customers in new ways;
- becoming more collaborative and integrated with other areas of public administration;
- building their skills to better exploit the large data pools they hold;
- creating new compliance management techniques; and
- enhancing their collection capabilities.[2]

In a "Commissioner Conversation" that reflected on the plenary meeting of the Forum of Tax Administrations (FTA), Pascal Saint-Amans (Director of the Centre for Tax Policy and Administration of the OECD) indicated that he sees two immediate and significant challenges for tax administrations:[3]

- tax administration 3.0[4] (digitalisation of business and digitising tax administrations), and
- the implementation of the fundamental changes necessary to address the international corporate income tax challenges arising from the digitalisation of the economy, as agreed by 136 member jurisdictions on 8 October 2021 (Pillar 1 and Pillar 2).[5]

For Pillar 1, the OECD is undertaking a rolling public consultation process to gather input from stakeholders. The organisation's official goal remains to publish the Multilateral Convention required for the global implementation of Pillar 1 before the end of 2022.

In this article, we will focus on Pillar 2 because it is considerably further advanced than Pillar 1. The Pillar 2 Model Rules[6] were released in 2021, and the Commentary[7] and illustrative examples[8] to the Model Rules were released in March 2022. The Pillar 2 Model Rules, which will be used by countries to implement the agreement domestically, are very complex and both taxpayers and tax administrations will face many challenges in implementing

1 M. Umar & N. Tusubira (2017). *Challenges of Tax Administration in Developing Countries,* Journal of Tax Administration. http://jota.website/index.php/JoTA/article/view/146.

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

3 https://youtu.be/Q0wRBJeocgM;https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/commissioner-conversations/?utm_source=Adestra&utm_medium=email&utm_content=Watch%20the%20video&utm_campaign=Tax%20News%20Alert%2007-04-2022&utm_term=ctp.

4 OECD (2020). *Tax Administration 3.0: The Digital Transformation of Tax Administration*, https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/tax-administration-3-0-the-digital-transformation-of-tax-administration.pdf..

5 OECD/G20, *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-october-2021.pdf.

6 OECD (2021). *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.pdf.

7 OECD (2022). *Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global AntiBase Erosion Model Rules (Pillar Two)*, https://www.oecd.org/tax/beps/tax-challenges-arising-from-thedigitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-commentary.pdf.

8 OECD (2022). *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) Examples*, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-examples.pdf.

them. In addition, the application of the Model Rules could lead to disputes between countries on the amount and the allocation of the so-called top-up tax (TT) under the income inclusion rule (IIR) or the undertaxed payment rule (UTPR).

This article provides some thoughts on how BRI jurisdictions could approach their Pillar 2 implementation. In particular, we suggest that initiatives related to the reduction of uncertainty, automation of tax processes, and enhancement of dispute resolution have the potential to significantly mitigate the challenges posed by Pillar 2.

## 2. Introduction to the Pillar 2 Concepts

Signatories to the OECD/G20 IF on Base Erosion and Profit Shifting (BEPS), originally released on 8 October 2021, politically commit to potentially fundamental reform of the international corporate tax system. At the time of writing, 137 out of 141 IF member jurisdictions have signed the agreement, including a large number of BRI jurisdictions.[9]

As part of this commitment, many jurisdictions originally aimed to implement Pillar 2 into domestic legislation by 2022 with effect as of 2023. This is an ambitious timeline,not only because of the political challenges of approving the legislation in the various countries, but also considering the many implementation challenges that will inevitably arise. We see an increasing number of countries postponing the implementation of Pillar 2 effectively to 2024, including the EU.[10] This is an ambitious timeline, not only because of the political challenges of approving the legislation in various countries, but also considering the many implementation challenges that will inevitably arise.

Conceptually, Pillar 2 aims to curb international tax competition by imposing a minimum level of effective taxation at 15% (the GloBE rules). Entities that are subject to lower effective tax rates in a certain jurisdiction would have the balance topped-up by another group entity in another jurisdiction.

As a primary rule, the Ultimate Parent (or, in certain cases, an Intermediary Parent) of the undertaxed entity would be subject to the IIR in its own residence country, with the effect of topping up its tax liability to 15%;

Alternatively, if no parent entity levies the IIR, the UTPR would come into effect, adjusting the profit of intra-group entities, so that the tax liability relating to the undertaxed entity's profit is effectively topped-up to 15%.

Put together, these rules would remove the incentive for jurisdictions to have effective tax rates lower than 15%; any taxation under this level would not benefit the taxpayer, but rather the jurisdiction where the top-up tax applies. In other words, jurisdictions would no longer be able to attract taxpayers through low taxation.

While the conceptual objective of the rules is straightforward, its implementation is not. From a legal perspective, concerns about the potential discriminatory effect of Pillar 2[11] and

9 OECD/G20. *Members of the OECD/G20 Inclusive Framework on BEPS Joining the October 2021 Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy as of 4 November 2021*, https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-members-joining-statement-on-two-pillar-solution-to-address-tax-challenges-arising-from-digitalisation-october-2021.pdf .

10 EU leaders suggest postponing the implementation from the first to the last day of 2023. See the compromise text of the draft Pillar Two Directive discussed by the Economic and Financial Affairs Council on March 15, 2022,https://data.consilium.europa.eu/doc/document/ST-6975-2022-INIT/en/pdf.

11 J.F. Pinto Nogueira. GloBE and EU Law: Assessing the Compatibility of the OECD's Pillar II Initiative on a Minimum Effective Tax Rate with EU Law and Implementing It within the Internal Market, 12 *World Tax J.*, IBFD (2020), https://research.ibfd.org/#/doc?url=/document/wtj_2020_03_e2_2; J. Englisch and J. Becker, International Effective Minimum Taxation – The GLOBE Proposal, 11 *World Tax J.*, IBFD (2019), https://research.ibfd.org/#/doc?url=/document/wtj_2019_04_int_1.

its compatibility with tax treaties[12] have already been raised – and can be expected to lead to future discussions. In addition, the recent release of the Model Rules, Commentary and Illustrative Examples highlights many practical challenges.

## 3. Approaching Practical Challenges Posed by Pillar 2 Rules

Implementing the Pillar 2 rules presents a number of challenges[13] including interpreting rules; performing the necessary tax base calculations; identifying, managing and monitoring the relevant data; auditing the data; enforcing compliance and resolving disputes.

In this section, we will explore several of these issues and discuss some of the approaches that taxpayers and tax administrations may wish to consider as they develop their approaches to implementing Pillar 2.

### 3.1 Creating a New Set of Tax Books

The Pillar 2 ambition of limiting tax competition implies, from the outset, the need for a common definition of the corporate income tax base. To avoid policy discussions that would have had to take into account different preferences from around the world, and to reduce the added burden that a completely novel calculation could create, a conscious choice was made to align the Pillar 2 tax base with the rules for income determination under Acceptable Financial Accounting Standards (most notably, IFRS).

As a significant number of accounting practices are simply not suitable for determining the tax base, this decision does not eliminate the practical challenges of Pillar 2 reporting. In fact, the necessary adjustments require such an extensive compliance exercise by taxpayers that it would be reasonable to compare it to a third set of books — accounting books, tax books, and Pillar 2 books.

Perhaps one of the most significant challenges facing Pillar 2 is that the basis for the calculation starts with the stand-alone entity accounts. Currently, most companies only use IFRS (or GAAP) to prepare their consolidated group financial statements. This means that any adjustments made to the local financial statements in the process of consolidating the numbers for group reporting purposes need to be reflected in the local books. In practice, however, we often see that these adjustments are monitored and booked at the consolidated level. A good example is the requirement to include intra-group transactions in the Pillar 2 tax base, subject to specific adjustments. This is because Pillar 2 takes the performance of each entity as its starting point while consolidated reporting is intended to represent the performance of the group as a whole and so excludes intra-group transactions. To implement this difference, it will be necessary, in practice, to ensure that intra-group transactions are recorded at arm's length (see article 3.2.3 of the Model Rules) at the level of the single entity accounts. Other complex accounting issues that are typically booked at consolidated level include lease accounting and purchase price allocation.

While the use of arm's length pricing is well understood in a tax context, incorporating it into the financial reporting of the local entity may require significant adjustments to the process. The complexity of the job lies not only in collating the information, but also in identifying the correct arm's length price for each transaction. Even if the Transfer-Pricing Guidelines are widely adopted, in certain situations, different jurisdictions may have different perspectives on the appropriate arm's length price, thus raising

12 L.E. Schoueri (2021). Some Considerations on the Limitation of Substance-Based Carve-Out in the Income Inclusion Rule of Pillar Two, 75 *Bull. Intl. Taxn.* 11/12, IBFD. https://research.ibfd.org/#/doc?url=/document/bit_2021_11_o2_10 (accessed April 21, 2022); M. de Wilde, *Why Pillar Two Top-Up Taxation Requires Tax Treaty Modification*, Kluwer Tax Blog (2022). http://kluwertaxblog.com/2022/01/12/why-pillar-two-top-up-taxation-requires-tax-treaty-modification/ .

13 L. Sheppard. How would GloBE be Enforced?, *Tax Notes International*, Volume 106, April 11, 2022, pp. 169-177.

uncertainty about which of the possible arm's length prices should be adopted. Additionally, later tax assessments requiring the adjustment of transfer prices for tax purposes would also require the amendment of the GloBE base retrospectively, thus increasing complexity.

Even once separate accounting adjustments are undertaken, other permanent differences between tax and book reporting need to be ironed out. For instance, intra-group dividends are income for accounting purposes, but are generally excluded from domestic tax bases to prevent a cascading effect (where longer corporate structures lead to multiple layers of taxation). This permanent difference leads to an exclusion of dividends from the Pillar 2 tax base (see article 3.2.1 of the Model Rules).

Another example of necessary adjustments can be found in the temporary differences between tax and book reporting. For instance, the rate of depreciation may differ in the two sets of books, even if over time those differences would be neutralised. To prevent Pillar 2 from unnecessarily capturing temporary differences, deferred tax adjustments are considered in the calculation of the minimum effective tax rate (see article 4.4 of the Model Rules). However, adjustments are necessary, for instance to ensure that the deferred tax adjustments are not calculated with a tax rate higher than the minimum rate of 15% and to ensure the recapture of deferred tax liabilities at a maximum within five years.

Incidentally, a comment submitted to the OECD during the public consultation process[14] underscores that the recapture of deferred tax liabilities within five years would require transactional level data about the registration of those positions — data which currently, according to the Acceptable Financial Accounting Standards, is not available. In other words, compliance with the provision would require taxpayers and tax administrations to implement a new methodology for reporting deferred tax positions, deviating from the intended simplicity.

These are only a few examples of the many practical challenges[15] involved in the implementation of Pillar 2. Despite the efforts of the OECD and the IF to design workable rules, it is no exaggeration to say that the compliance obligations that will be created are tantamount to the creation of a third set of books — with the potential to proportionally increase the compliance burden.

To mitigate this increase in compliance burden, we believe that it would be in the best interest of taxpayers and tax administrations alike to leverage all available tools to enhance simplification. In particular, we believe that automation, cooperative compliance and enhanced dispute resolution should be key elements in streamlining the implementation of Pillar 2.

### 3.2 Developing a Data-driven and Technology-enabled Approach

Tax administrations are confronted with an ever-increasing flow of data, from both internal and external sources. Large amounts of information are retrieved from financial intermediaries, other government agencies, public sources, sustainability reports and from tax administrations in other territories. Pillar 2 will add yet another layer to this data-universe and so further increase the need for a solid data governance framework and an enabling data architecture, underpinned by IT. Tax administrations have to turn huge amounts of data into relevant information that provides certainty on Pillar 2 compliance, and as an enabler for cost-efficient processes as a result of standardisation and automation.

With a data-centric strategy, tax administrations will enable themselves to significantly

14 C. Kaeser & H. Wehner, *Siemens' Response to the Public Consultation on the GloBE Implementation Framework of the Global Minimum Tax (Pillar Two). Public Comment submitted to the OECD*, https://www.oecd.org/tax/beps/public-comments-received-on-the-implementation-framework-of-the-global-minimum-tax.htm.

15 Lee Sheppard. *How Would GloBE Be Enforced?*, Tax Notes International, Volume 106, April 11, 2022, pp. 169-177.

improve their performance on Pillar 2 (and related) processes, in particular through faster workflows, improved taxpayer services, better prevention of tax fraud and near to real-time evaluation of the impact of macro-economic trends and policy changes.

The transformation journey towards becoming a data-intelligent tax administration, including data-driven Pillar 2 operations, requires operational excellence and technical transformation.

Operational excellence requires a well-designed Pillar 2 strategy, an operational and legal framework, proper technological infrastructure, adequate change management and relevant performance measurement.

Technology will support the transformation of a Pillar 2 data collection from a storage process to the ability to provide detailed insight, at every stage of the process. Data platforms and intelligent (cloud) technology, as well as leveraging machine learning and artificial intelligent tools, will contribute to this journey.

As a result, a significant reduction in the amount of manual processes can be realised. Besides the efficiency gain within the tax administration, taxpayers will also benefit through, for example, the automated extraction of data from their enterprise resource planning (ERP) system to the data platform of the tax administration, providing information only once to meet a broader range of tax compliance obligations, and transparency on recalculations and data analytics for Pillar 2 compliance.

For tax administrations, overcoming the challenges of Pillar 2 requires a strong foundation to begin with. Fundamental to this is a platform for ingesting data, transforming data into the data model of the tax administration, enriching data and working with that data to gain insights, perform recalculations, cross-check data sources and gain certainty on taxpayers' compliance with their tax obligations. Typically, a data platform for tax administrations comprises data sources, data ingestion, data integration, data access, reporting & analytics and governance.

(i) Data sources are the identified sources from which the data can be collected.

These could be both authentic data sources, used as a single source of truth, and external data sources which are used to combine and enrich data. Being able to connect to different data sources is a necessary function of a tax administration's data platform. For Pillar 2, this could mean the retrieval of cross-border data from other tax administrations to perform cross-checks but also the automated retrieval of financial data from a tax ledger within a taxpayer's accounting system.

(ii) Data ingestion is the process of capturing information, followed by predefined modification and cleansing rules, validating the data and finally uploading the information to a platform.

A data ingestion engine will normalise serialised data (structure them for a tax administration database format) and store them in the database. This can be done in real time or periodically in bulk. Some of the more than 120 data points relevant to Pillar 2 could be extracted in an automated way by running 'executables' that take data from ERP tables.

Only structured data, captured in, for example, ERP tables can be ingested in an automated way, enabling taxpayers to efficiently collect the data needed to meet their broader compliance obligations. This could provide a strong incentive for taxpayers to record more relevant data points in primary data sources like their ERP system, for instance on a tax ledger, thus moving away from unstructured data in emails, excel files and documents on shared drives.

(iii) Data integration is the process by which data is transformed into a format required by the data model of the tax administration.

More often than not, effective movement of information from one system to another requires the reformatting or restructuring of that data. Data from multiple sources often needs to be combined, filtered by a set of criteria, and/or enriched with other data.

This component can be divided into 3 layers:

– Data transformation: a layer of data integration that transforms ingested data from one format to another. For Pillar 2, a common taxonomy could be developed to provide a prescribed business reporting standard to facilitate formatting challenges.

– Data manipulation: a layer of data cleansing, validation, standardisation and categorisation. For Pillar 2, this challenge could be overcome by prescribing an ERP set-up and specific accounting standards.

– Data processing: a layer of data integration, consisting of the manipulation of data and its translation into usable information.

(iv) Data access (storage) is a component providing uniform access to the data store of the tax administration.

A data store is a central data "hub" for the whole platform of a tax administration, including multiple data stores, such as: internationally exchanged data, historical taxpayer data, user management, data received from chain partners and financial data.

(v) Reporting & analytics

With the help of reporting logic, users can extract the necessary data from the data stores and perform descriptive and diagnostic analyses on Pillar 2 compliance by recalculating, cross-checking and analysing data using the platform's data sets.

(vi) Data management/governance covers the entirety of process monitoring, controlling of data quality, management of APIs, security and user/access management.

This covers the technical components for data management and data governance as part of the technical architecture, which should be implemented and configured to support the organisational elements of data governance (e.g., processes, roles and responsibilities, data policies).

In conclusion, it's worth noting that digital transformation is never only about processes and technology. The third essential element to achieve digital transformation is the people who will have to work on and with these processes and enabling technology. This means taking people into account when designing processes and procedures, providing upskilling programmes, recruitment and allowing for the development of the workforce over time.

At the same time, tax administrations need to rethink their workforce of the future. More accounting skills are needed in the domain of Pillar 2 but also data-scientists, technical experts and cybersecurity specialists.

In summary, tax administrations will need to rethink the skills needed and how to attract and retain the right talent to build a future-proof tax administration workforce.

### 3.3 Building a Cooperative Compliance Approach

Pillar 2 will present both taxpayers and tax administrations with a steep learning curve as they seek to resolve the accounting, tax technical and data challenges outlined above. If they work together, however, drawing on the principles that underpin a cooperative compliance approach, there could be significant benefits for all. Furthermore, cooperative compliance programs, in combination with certified tax assurance programs, could support compliance with and enforcement of Pillar 2.

#### 3.3.1 A joint and cooperative learning curve in the implementation phase

The promotion of a cooperative relationship between tax administrations and taxpayers is a relatively new phenomenon. Successful country experiences led the OECD to report on the "enhanced relationship" approach[16] (later termed cooperative compliance[17]), based on mutual trust, transparency and understanding. The benefits of the approach included better information for revenue bodies, enabling more effective risk management and resource allocation, as well as a greater understanding by the authorities of the commercial drivers of taxpayers, which improved taxpayer certainty.

While the idea of cooperative compliance has been developed mainly with everyday tax management in mind, it could also be leveraged in the implementation phase of Pillar 2. In par-

16 OECD(2008). *Study into the Role of Tax Intermediaries*, https://doi.org/10.1787/9789264041813-en.

17 OECD(2013). *Co-operative Compliance: a Framework*, https://doi.org/10.1787/9789264200852-en.

ticular, it is important that taxpayers and tax administrations start working together from the outset, to create a common understanding of the challenges involved and agree on practical solutions that are acceptable for both parties.

With the enhanced understanding and information accrued from this joint effort, taxpayers and tax administrations can upskill their workforces and work towards execution with the lowest possible cost of compliance for all parties while having certainty on Pillar 2 compliance aspects. Additionally, the identification of challenges may also lead to the development of innovative solutions — e.g., the volume of cross-border exchange of information and necessary cross-checks could lead to the development of a common taxonomy, specifically for Pillar 2 reporting purposes. The taxonomy could be comparable to Extensible Business Reporting Language (XBRL), for example, or other examples of prescribed reporting formats.

#### 3.3.2 Cooperative compliance and tax assurance in the application phase

In addition to its importance in the implementation phase, leveraging cooperative compliance for the management of Pillar 2 could be key to successfully mitigating the potentially high compliance burden.

The key insight of a cooperative compliance approach to Pillar 2 would be to focus tax administration efforts on the tax processes, rather than on the outcomes of these processes. Indeed, tax administrations traditionally perform supervision activities on the outcomes of tax processes of their taxpayers, with tax reporting as a starting point. The relatively recent experiences with cooperative compliance, in contrast, leverage the Tax Control Framework[18] (TCF) of a taxpayer, providing comfort about the quality of the information received, thus mitigating the necessary supervision of the outcomes.

Innovation in this respect would be to jointly define (prescribed) criteria for design, implementation and monitoring of Pillar 2 legislation within the TCF. The form and intensity of tax administration supervision could vary based on whether the criteria have been met. To take it one step further, accredited external auditors could provide tax assurance based on their tax audit in accordance with yet to be defined TCF audit standards.

Overall, a cooperative compliance approach to Pillar 2 processing would enable tax administrations to better allocate scarce audit resources, while offering taxpayers the ability to elect for a more efficient and certain form of tax administration supervision.

### 3.4 A Multilateral Mechanism to Determine and Allocate the Top-up Tax

As discussed in the previous sections, the complexity of the Pillar 2 reporting may give rise to significant compliance burdens – which may be mitigated with the initiatives discussed in sections 3.2 and 3.3. Another consequence of complexity is the potential uncertainty it may create. We therefore believe that the implementation of Pillar 2 would significantly benefit from dispute prevention and resolution initiatives.

To date, no specific dispute prevention and resolution initiatives have been suggested for Pillar 2. In contrast with the innovative approaches described in the Pillar One Blueprint,[19] the Pillar 2 Model Rules do not touch on the matter while the Blueprint[20] mainly refers to existing dispute resolution mechanisms.

18 Six essential building blocks of a TCF are: (1) Tax Strategy established; (2) Applied Comprehensively;(3) Responsibility Assigned; (4) Governance Documented; (5) Testing Performed and (6) Assurance Provided. OECD (2016). *Co-operative Tax Compliance: Building Better Tax Control Frameworks.*

19 Paragraphs 17-19, and Chapter 9 of OECD (2020). *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project*, https://doi.org/10.1787/beba0634-en.

20 OECD (2020). *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, https://doi.org/10.1787/abb4c3d1-en.

Indeed, the Blueprint's narrative indicated that the IIR and the UTPR "(...) have been designed in a way to minimise the scope for disputes concerning their application across multiple jurisdictions primarily because of the rule order and the binary way in which they operate (...)".[21] However, as indicated in section 3.1, Pillar 2 still contains several conceptual and practical challenges that may lead to disputes and possible double taxation.

The Blueprint suggests that if the application of the GloBE rules results in double taxation, existing mechanisms can be used to prevent and solve disputes. More specifically, existing mechanisms allow for the exchange of information and simultaneous tax examinations under the Convention on Mutual Administrative Assistance in Tax Matters (MAAC),[22] and for a request for competent authority assistance under the mutual agreement procedure provisions of art. 25, paragraph 3 of the OECD Model Tax Convention. The provision contained in the second sentence of art. 25, paragraph 3 of the OECD Model Tax Convention, allows competent authorities to consult together to eliminate double taxation in cases that are not provided for in the Convention.

However, the IIR and the UTPR are domestic rules and will not be incorporated into tax treaties. According to the IF, this would require "that the jurisdictions involved in the double taxation have entered into a tax treaty with each other, and that they have the authority to resolve the case, which may not be the case for all jurisdictions involved".[23] Indeed, the lack of domestic law support for the operation of article 25(3) may be regarded, in certain countries, as a significant limit to its effectiveness, which led Danon et al. to suggest that the Model Rules should be amended to require domestic law support for article 25(3).[24] Besides, even where the operation of article 25(3) would be possible, its effectiveness in resolving Pillar 2 disputes would depend on the goodwill of the countries and tax administrations involved. It is hoped that any double taxation could be resolved with greater certainty.

In this context, the indication in the Blueprint that the IF will "explore the development of a multilateral convention which could then also contain provisions for dispute prevention and resolution concerning the application of the GloBE rules" is welcome.[25] However, in view of the lack of concrete developments in the Model Rules and Commentaries, countries and regional blocs may wish to take proactive action to promote state-of-the-art dispute prevention and resolution mechanisms.

Against this backdrop, the Belt and Road Initiative jurisdictions may wish to consider developing a panel mechanism in order to prevent and resolve disputes, along the lines of the design of these mechanisms as described in the Pillar 1 Blueprint.[26] This would help to provide certainty and mitigate the potential for litigation, in addition to expanding the potential co-operation between taxpayers and tax administrations in the cross-border context.

21 Par. 711 of the Report on Pillar Two Blueprint.

22 The Convention on Mutual Administrative Assistance in Tax Matters as Amended by the 2010 Protocol (OECD, 2011[17]) (the MAAC) is a multilateral treaty aimed at assisting countries to better enforce their tax laws by providing an international legal framework for exchanging information and co-operating in tax matters with a view to countering international tax evasion and avoidance. As of June 2020, there are 137 jurisdictions participating in the MAAC.

23 Par. 714 of the Report on Pillar Two Blueprint.

24 R. Danon, D. Gutmann, G. Maisto & A. Jiménez. *Implementation Framework of Global Anti-Base Erosion ("GloBE") Rules, Dispute Resolution Possibilities under the Current International Tax Framework. Public Comment submitted to the OECD by April 11, 2022.* https://www.oecd.org/tax/beps/public-comments-received-on-the-implementation-framework-of-the-global-minimum-tax.htm.

25 Par. 715 of the Report on Pillar Two Blueprint.

26 See footnote 18.

# The OECD/G20 Two-Pillar Solution: A "Giant Leap" for Multinational Groups

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***Abstract***: This new era, shaped dramatically by technology developments and globalization, requires not just an overhaul of existing tax systems but a radical shift in the international tax perspective overall. As the national legislators and tax authorities struggle to keep pace with the evolving technology, an international and coordinated solution appears pivotal. Coordinated and coherent solutions have been put forward by the OECD and G20 countries with Action Plan (addressing BEPS with 15 actions to be implemented in domestic tax frameworks). As for the challenges arising from digitalization, further headway still needs to be made. Hence, one of the essential tasks of the OECD/G20 Inclusive Framework is to address such tax challenges arising from the digitalization of the global economy. Challenges like these are tackled with the so-called "Two-Pillar Solution", which aims at ensuring that multinational enterprises pay a fair share of tax wherever they operate and generate profits. On the one hand, the "Two-Pillar Solution" ensures that profits are taxed where economic activities take place and where value is created while, on the other hand, it creates a level playing field for multinational enterprises as regards taxation. It is still though too early in the day to judge whether this Two-Pillar Solution will ultimately reach its goals. However, what is clear is that this solution amounts to a major change in international taxation or as I call it: "A 'Giant Leap' for Multinational Groups".

***Keywords***: OECD; Pillar 1; Pillar 2; Minimum tax; IIR; UTPR

## 1. Introduction

The rapid and unrelenting evolution of technology and the increasing internationalization of companies pose new challenges in the international tax landscape. This aspect clearly impacts on the erosion of the tax base of jurisdictions. Over the years, jurisdictions and international organizations have addressed this issue and identified possible solutions.[1]

1 Among the others, OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (IF) 2015.

Lately, in order to provide a unified and coordinated solution, the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (hereinafter referred to as "IF") has agreed on a two-pillar solution to address the tax challenges arising from the digitalization of the economy (hereinafter referred to as "Two-Pillar Solution"). [2]

The Two-Pillar Solution consists of (i) Pillar 1 aimed at reallocating taxing rights amongst market jurisdictions and (ii) Pillar 2 aimed at introducing a minimum level of effective taxation (15%) for certain multinational enterprises (MNEs) .[3]

The Two-Pillar Solution highlights the ineffectiveness of the measures previously conceived at the international level as well as those adopted independently by a single jurisdiction to address the tax ramifications of the digital economy.[4] This clearly surfaces from the "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy" that reads as follows: "The Multilateral Convention (MLC) will require all parties to remove all Digital Services Taxes and other relevant similar measures with respect to all companies, and to commit not to introduce such measures in the future. No newly enacted Digital Services Taxes or other relevant similar measures will be imposed on any company from 8 October 2021 and until the earlier of 31 December 2023 or the coming into force of the MLC. The modality for the removal of existing Digital Services Taxes and other relevant similar measures will be appropriately coordinated."

## 2. Pillar 1 at a Glance

The OECD Pillar 1 aims at creating a framework to address the taxation of the digitalized economy with a view to reallocating profits amongst the "market jurisdictions" and expanding their taxing rights in cases where a specific link between the relevant business activity and the given market jurisdictions exists.

To this end, Pillar 1 provides for profit allocation mechanisms and nexus rules.[5]

The basic elements of Pillar 1 are the following:

- Amount A: the allocation of a share of residual profit to market jurisdictions (it applies to in-scope companies only);
- Amount B: the application of the arm's length principle to in-country baseline marketing and distribution activities (it applies to all businesses); and
- Tax certainty: binding dispute prevention and resolution mechanisms.

In-scope companies are the multinational enterprises — engaged in in-scope activities[6] — with global turnover above EUR20 billion and profitability above 10% (i.e., profit before tax/revenue) calculated using an averaging mechanism with the turnover threshold to be reduced to EUR10 billion, contingent on

2 Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, dated 8 October 2021 and endorsed by 137 IF members.

3 On 20 December 2021, the OECD issued the Pillar 2 Model Rules. On 14 March 2022, the OECD released the (i) "OECD (2022). *Tax Challenges Arising from the Digitalisation of the Economy — Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)*", https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-commentary.pdf, and the (ii) "OECD (2022). *Tax Challenges Arising from the Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two) Examples*", https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-examples.pdf.

4 E.g., Italian digital tax.

5 To date, Pillar 1 blueprint is still a "work-in-progress" as the OECD is currently seeking public comments on the Draft Rules for Nexus and Revenue Sourcing under Pillar 1 Amount A.

6 Pillar 1 provides for specific types of activities to be excluded from Amount A.

the successful implementation, including tax certainty on Amount A, with the relevant review beginning seven years subsequent to the agreement coming into force, and the review being completed in no more than one year.[7]

### 2.1 Nexus and Revenue Sourcing Rules

The nexus rule provides for the allocation of Amount A residual profit to a market jurisdiction when the in-scope MNE derives at least EUR1 million in revenue from that jurisdiction. For smaller jurisdictions, with GDP lower than EUR40 billion, the nexus will be set at EUR250,000.

Revenue sourcing rules are aimed at determining the market jurisdiction(s) where the revenue is sourced for Amount A purposes. Detailed sourcing rules for specific categories of transactions will be developed.

### 2.2 Quantum

For in-scope MNEs, 25% of residual profit defined as profit in excess of 10% of revenue will be allocated to market jurisdictions with nexus using a revenue-based allocation key.

### 2.3 Tax Base Determination

The Amount A tax base is determined on the basis of the in-scope MNE profits. It will be determined with reference to financial accounting income, along with a small number of adjustments.

A loss carry-forward mechanism will be provided to allow losses to be taken into account in the computation of Amount A.

Segmentation will only apply in exceptional circumstances where, based on the segments disclosed in the financial accounts, a segment meets the scope rules.

### 2.4 Elimination of Double Taxation

Double taxation of profit allocated to market jurisdictions will be relieved using either the exemption or credit method.

### 2.5 Tax Certainty

An ad hoc dispute prevention and resolution mechanism is envisaged for Amount A matters. These mechanisms will prevent double taxation from arising as a result of the application of Pillar 1 (Amount A). Disputes in question (including those concerning whether the matter at stake may relate to Amount A) will be sorted out in a mandatory and binding manner.

### 2.6 Amount B

This part of Pillar 1 aims at simplifying and streamlining the application of the arm's length principle to in-country baseline marketing and distribution activities and the tax compliance relating thereto (including filing obligations).

## 3. Pillar 2 Model Rules at a Glance

The Pillar 2 Model Rules ("Global Anti-Base Erosion" or "GloBE Rules") are part of the Two-Pillar Solution addressing the tax aspects related to the digitalization of the economy. The Pillar 2 Model Rules have been prepared and approved with the unanimous consent of delegates from all members of the IF.

The GloBE Rules aim to ensure that MNEs falling within the subjective scope of the framework ("in-scope MNEs") are subject to a minimum level of effective taxation on income earned within each jurisdiction in which they operate (to achieve a level of effective taxation on the MNE excess profit), taking into account a substance-based carve out in a jurisdiction up to the minimum rate of 15%. The top-up tax governed by the GloBE Rules is calculated and applied at a jurisdictional level.

Taxpayers falling within the subjective scope of the Pillar 2 Model Rules are required to calculate the effective tax rate (ETR) for each jurisdiction wherein they operate and pay the relevant top-up tax.

The top-up tax rate amounts to the positive difference between the minimum rate (15%)

7 Extractives and Regulated Financial Services are excluded.

and the ETR (calculated on a per-jurisdiction basis). The top-up tax (calculated on a per-jurisdiction basis) is calculated as the top-up tax rate (of the relevant jurisdiction) multiplied by the GloBE income (derived by the in-scope MNE in that jurisdiction).

The top-up tax is applied in accordance with two sets of rules (either alternative or competing, depending on the case). The rules referred to are the Income Inclusion Rule (IIR) and the Undertaxed Payment Rule (UTPR).

The IIR takes precedence over the UTPR, which serves as a backstop rule. Under the IIR, in principle, the top-up tax is paid by the ultimate parent entity in proportion to its interest in the entities located in a low-tax jurisdiction.

To ensure effectiveness and to avoid any loopholes, the Pillar 2 Model Rules also provide for a backstop rule. The backstop rule in question is the UTPR.

The UTPR imposes the entities belonging to the in-scope MNE to adjust their tax basis (e.g., through the disallowance of a tax deduction) to cause an increase of their effective tax rate. The goal of the UTPR is to make the group entities pay, as a result of the said adjustment, the residual top-up tax that has not been paid under the IIR.

The share of top-up tax to be allocated to each entity belonging to the in-scope MNE is calculated on the basis of a specific formula. This ensures the measure is more effective as the reasonability of making the adjustment and paying the relevant tax rests with those entities that show the ability to pay the required amount of top-up tax.

The same calculations apply when the top-up tax is applied under the IIR or UTPR to preserve consistency.

The Pillar 2 Model Rules adopt a top-down approach imposing, in principle, a response in the hands of the ultimate parent company of the in-scope MNE (hereinafter referred to as "UPE")[8]. The Pillar 2 Solution makes it less attractive for the in-scope MNEs to operate in low-tax jurisdictions. As a matter of fact, the potential tax advantage arising from resorting to these jurisdictions (in terms of a lower effective tax rate) is de facto obliterated by the application of the measures implementing the Pillar 2 Model Rules imposing a minimum level of effective taxation of 15% to be applied, in principle, in the jurisdiction where the UPE is located.

Low-tax jurisdictions may, on the one hand, revamp their tax laws to achieve the minimum level of effective taxation or, on the other hand, provide for new rules consistent with the Pillar 2 Model Rules to be applied on a domestic basis (to achieve the desired level of effective taxation). In either case, the competitive advantage, represented by the tax advantage provided by such jurisdictions prior to the implementation of the Pillar 2 Model Rules, will be nullified.

The Pillar 2 Model Rules serve as a tool, a blueprint to be employed by the IF's member jurisdictions to implement the GloBE Rules within their domestic tax framework. The purpose of the Pillar 2 Model Rules is, thus, to help IF's member jurisdictions transpose the GloBE Rules while ensuring a coherent and coordinated implementation. Furthermore, the Pillar 2 Model Rules are broad and flexible enough to adapt to a wide range of tax systems.

As far as the entry into force of the GloBE Rules is concerned, the Pillar 2 Model Rules must be implemented in the domestic framework of the IF's member jurisdictions by 2022, to be effective in 2023. Nevertheless, the UTPR must become effective at a later stage (2024). For EU member states it is likely that the application of both IIR and UTPR shall be postponed by one year.

8 Model Rules, Article 1.4. Ultimate Parent Entity means either: (A) an Entity that: (a) owns directly or indirectly a Controlling Interest in any other Entity; and (b) is not owned, with a Controlling Interest, directly or indirectly by another Entity; or (B) the Main Entity of a Group that is within Article 1.2.3.

## 4. Subjective Scope of the Pillar 2 Model Rules

### 4.1 In-scope MNE

In-scope MNEs are those multinational groups[9] that have annual revenue of EUR750 million or more in the Consolidated Financial Statements[10] of the Ultimate Parent Entity[11] in at least two of the four fiscal years[12] immediately preceding the tested fiscal years.[13] If one or more of the fiscal years of the group is of a period other than 12 months, for each of those fiscal years the EUR750 million threshold is adjusted proportionally to correspond with the length of the relevant fiscal year.[14]

The GloBE Rules apply to Constituent Entities[15] of an in-scope MNE; any permanent establishment of a group entity is to be treated as a separate Constituent Entity for the purpose of GloBE Rules. This means that it is necessary to identify the jurisdiction where the permanent establishment is located, to allocate qualifying income and covered taxes thereto as if it were a separate entity, independent from the headquarters.

A specific set of rule addresses the localization of the Constituent Entities. These rules rely on the local tax treatment accorded to the given Constituent Entity.[16]

### 4.2 Excluded Entities

Taxpayers that have no foreign presence (single entities or groups of purely domestic significance) or that have less than EUR750 million in consolidated revenues in the relevant time-period do not fall within the scope of GloBE Rules.

In addition, GloBE Rules do not apply to governmental entities, international organizations and non-profit organizations (thus preserving domestic tax exemptions for sovereign, non-profit and charitable entities). Furthermore, GloBE Rules do not apply with respect to entities that fall within the definition of a pension fund, investment fund or real estate (thus preserving the widely accepted tax policy

9 Model Rules, Article 1.2.1. Defined Terms. An MNE Group means any Group that includes at least one Entity or Permanent Establishment that is not located in the jurisdiction of the Ultimate Parent Entity. Model Rules, Article 1.2.2. and 1.2.3. Defined Terms. A Group means a collection of Entities that are related through ownership or control such that the assets, liabilities, income, expenses and cash flows of those Entities: (a) are included in the Consolidated Financial Statements of the Ultimate Parent Entity; or (b) are excluded from the Consolidated Financial Statements of the Ultimate Parent Entity solely on size or materiality grounds, or on the grounds that the Entity is held for sale. A Group also means an Entity that is located in one jurisdiction and has one or more Permanent Establishments located in other jurisdictions provided that the Entity is not a part of another Group described in Article 1.2.2. As a result, an (in-scope) Group could also consist of a single entity having one or more permanent establishments.

10 Model Rules, Article 10.1. Defined Terms, provides for the definition of the term "Consolidated Financial Statements".

11 Model Rules, Article 1.4.

12 Model Rules, Article 10.1. Defined Terms, provides for the definition of the term "Fiscal Year". To ensure consistency, the definition in question refers to the accounting period. Indeed, the term Fiscal Year means "an accounting period with respect to which the Ultimate Parent Entity of the MNE Group prepares its Consolidated Financial Statements. In the case of Consolidated Financial Statements as defined in paragraph (d) of its definition, Fiscal Year means the calendar year".

13 An MNE Group needs first to determine whether it falls within the scope of the GloBE Rules. If so, it must then identify all the constituent entities belonging to the group and their respective location. Article 1.1 determines which MNE Groups and Group Entities fall within the scope of the GloBE Rules.

14 Article 6.1 of the Model Rules sets out specific rules which modify the application of the consolidated revenue threshold in certain cases.

15 Model Rules, Article 1.3.1.

16 Model Rules, Article 10.3.

that excludes an additional layer of taxation between the investment and the investor).[17] These entities are also excluded in the event that the multinational group they control is subject to the GloBE Rules.

Although the Excluded Entities are beyond the scope of the application of GloBE Rules, their revenue is taken into account for the purposes of the consolidated revenue test.

Furthermore, GloBE Rules continue to apply to an Excluded Entity's ownership interest in other Constituent Entities.

## 5. Functioning of the Pillar 2 Model Rules

In-scope MNEs must calculate the ETR for each jurisdiction wherein they operate and pay the top-up tax equal to the positive difference (if any) between the minimum rate (15%) and the ETR.

For each fiscal year[18] and with respect to each relevant jurisdiction, the Pillar 2 Model Rules require the in-scope MNEs to:

(a) calculate the ETR;

(b) calculate the top-up tax; and

(c) determine the liability for the top-up tax.

Figure 1 is a chart contained in the OECD Overview of the Key Operating Provisions of the GloBE Rules.

## 6. Calculation of the ETR

To apply the GloBE Rules, it is necessary, first, to calculate the ETR in relation to each jurisdiction wherein the in-scope MNE operates. The ETR is calculated as follows:

(adjusted) Covered Taxes/GloBE Income

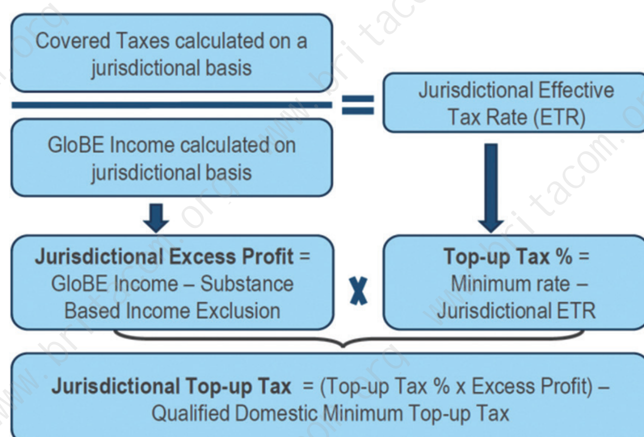


Figure 1. Computation of the jurisdictional top-up tax

Chapter 3 of the Pillar 2 Model Rules provides rules to calculate the GloBE Income (or Loss) of a Constituent Entity. GloBE Income (or Loss) is determined by applying the adjustments set forth by Articles 3.2. to 3.5.[19] to the Financial Accounting Net Income (or Loss) for the fiscal year.

Pursuant to Article 3.1., the Financial Accounting Net Income or Loss is the net income or loss that is used for preparing Consolidated Financial Statements of the UPE before the writing-off of intra-group items.

The resort to the financial accounting net income (or loss) stems from the need to employ a harmonized standard in all jurisdictions and to

17 Model Rules, Article 1.5. sets out the definition of Excluded Entity. Pursuant to Article 1.5.3., a Filing Constituent Entity may elect not to treat an Entity as an Excluded Entity under Article 1.5.2. An election under this Article is a Five-Year Election.

18 Model Rules, Article 10.: "Fiscal Year means an accounting period with respect to which the Ultimate Parent Entity of the MNE Group prepares its Consolidated Financial Statements. In the case of Consolidated Financial Statements as defined in paragraph (d) of its definition, Fiscal Year means the calendar year."

19 Financial Accounting Net Income (or Loss) must be adjusted to eliminate the following book to tax differences: (i) Excluded Dividends; (ii) Excluded Equity Gain or Loss; (iii) Policy Disallowed Expenses; (iv) Stock-based compensation; (v) Asymmetric Foreign Currency Gains; and (vi) Excluded International Shipping Income.

ensure, thus, coherence and consistency.[20]

Financial Accounting Net Income or Loss must be adjusted to eliminate a number of common book to tax differences. These adjustments include inter alia: excluded dividends; excluded equity gain or loss; asymmetric foreign currency gain or loss; policy disallowed expenses; stock-based compensation; and excluded international shipping income.

The income so determined is to be allocated to permanent establishment and flow-through entities belonging to the in-scope MNE (if any).

As far as relevant taxes are concerned, Chapter 4 of the Pillar 2 Model Rules refers to income taxes, to be understood in a broad sense to include taxes imposed on a Constituent Entity's income or profits as well as taxes that are functionally equivalent to such income taxes and taxes on retained earnings and corporate equity. Covered taxes do not include, however, taxes not based on income, such as indirect taxes, payroll taxes and real estate taxes.

The starting point to determine the numerator of the formula (i.e., the adjusted covered taxes) is the Constituent Entity's current taxes for the relevant fiscal year. This value is then to be adjusted pursuant to the provisions of Articles 4.1.2. through 4.1.5. For example, some adjustments aim at excluding taxes that are not related to GloBE Income or Loss.

GloBE Rules also provide for a mechanism to address temporary differences, which is based on the mechanisms of deferred tax accounting.[21] Safeguards are provided to limit the recognition of the deferred tax assets and liabilities to the minimum rate and a recapture rule to ensure that amounts claimed as covered taxes are effectively paid within a set period of time.

Article 4.6. of GloBE addresses post-filing changes to a Constituent Entity's liability for covered tax setting out rules to identify the fiscal year to which those changes are to be attributed.

## 7. Determining the Top-up Tax

The top-up tax rate amounts to the difference between the minimum rate (15%) and the ETR (of the relevant jurisdiction).

The top-up tax rate must then be applied to the Jurisdictional Excess Profit of the relevant jurisdiction.

The Jurisdictional Excess Profit of the relevant jurisdiction is equal to the GloBE income of that jurisdiction less the substance-based income exclusion of that jurisdiction.

The substance-based income exclusion is calculated as a percentage of property, plant and equipment and personnel costs.[22]

Finally, the top-up tax for the jurisdiction is reduced by any applicable Qualified Domestic Minimum Top-up Tax.[23]

GloBE Rules provide for de minimis exclusion[24] and allow for development of safe harbors[25].

The de minimis exclusion applies to jurisdictions where the in-scope MNE has (i) an Average GloBE Revenue[26] that is less than

20 In case a Constituent Entity has one or more Permanent Establishments, the GloBE Income attributable to that Constituent Entity is allocated between the Main Entity and the Permanent Establishment(s) in accordance with the local tax treatment. A similar rule applies to Flow-through Entities (allocation between the entity and the owners) and CFCs (allocation between the owner and the CFC). This rule ensures that the relevant covered taxes are allocated to the jurisdiction where the income is earned.

21 Model Rules, Article 4.4. Article 4.5. allows MNE Groups to use an optional simplified rule that can be applied in lieu of the deferred tax accounting approach set out in Article 4.4.

22 Model Rules, Article 5.3.

23 Model Rules, Article 5.2.3.

24 Model Rules, Article 5.5.

25 Model Rules, Article 8.2.

26 Model Rules, Article 5.5.2.

EUR10 million and (ii) an Average GloBE Income or Loss[27] that is either a loss or less than EUR1 million, computed on a three-year average basis.

GloBE safe harbors are to be developed as part of the GloBE Implementation Framework. These rules will aim at limiting compliance and administration burdens for those aspects of an MNE's operations that are likely to be taxable at or above 15% on a jurisdictional basis. The final design of any safe harbors will be developed further in consultation with businesses and stakeholders and reflected in the Implementation Framework to be released in 2022.

## 8. Identifying the Constituent Entity Responsible for Applying the Top-up Tax

GloBE Rules follow a top-down approach. Top-up tax (IIR) liability falls primarily on the UPE. However, if the jurisdiction where the UPE is located has not implemented GloBE Rules or a different set of rules other than those coherent with GloBE Rules (qualified income inclusion rule), or the UPE is an excluded entity, the IIR is to be applied and collected by one or more Intermediate Parent Entities (IPE).

IPE means a Constituent Entity (other than an Ultimate Parent Entity, Partially-Owned Parent Entity (POPE) Permanent Establishment, or Investment Entity) that owns (directly or indirectly) an ownership interest in another Constituent Entity in the same MNE group.

Furthermore, the IIR is subject to a split-ownership rule for shareholdings below 80%. Indeed, the top-down approach is derogated in the case that the in-scope MNE comprises one or more POPE (i.e., a Constituent Entity (other than an Ultimate Parent Entity, Permanent Establishment, or Investment Entity) that: (a) owns (directly or indirectly) an ownership interest in another Constituent Entity of the same MNE group; and (b) has more than 20% of the ownership interests in its profits held directly or indirectly by persons that are not Constituent Entities of the MNE group). In such case, the responsibility to apply the top-up tax falls on the highest-level POPE or to a POPE further down the chain.

As the IIR may apply at different levels of the in-scope MNE, GloBE Rules provide for an offset mechanism to prevent double taxation from arising.

## 9. Allocation of the Top-up Tax Between Low Taxed Constituent Entities

The jurisdictional top-up tax is allocated to Constituent Entities in the low-tax jurisdiction that have GloBE Income for the fiscal year (and in proportion to their allocable share) in order to determine which entity triggers a charge to top-up tax.[28]

The allocable share of top-up tax is determined on the basis of a parent entity's inclusion ratio[29].

An offsetting mechanism is provided to avoid an unintended multiple application of the IIR in respect of the same low-taxed Constituent Entity.[30]

## 10. Identification of the Remaining Amount, If Any, That Is Allocable under the UTPR

If the entire amount of the top-up tax has not been allocated under the IIR, the UTPR kicks in. The UTPR serves as a backstop mechanism to the IIR in situations where there is no qualifying IIR in the jurisdiction of the UPE or where a low level of taxation arises in the jurisdiction of the UPE. If there is low-taxed income beneficially owned by a UPE that is not brought into charge under an IIR, the low-taxed income is subject to the back-up mecha-

27 Ibid.

28 Model Rules, Article 5.2.4.

29 Model Rules, Article 2.2.2.

30 Model Rules, Article 2.3.

nism of the UTPR[31].

The UTPR top-up tax amount is allocated among the UTPR jurisdictions on the basis of a two-factor formula (allocation key based on (i) the net book value of tangible assets held and (ii) the number of employees employed by all the Constituent Entities that are located in such UTPR jurisdictions).

The UTPR top-up tax amount allocated to a jurisdiction may be collected by the relevant jurisdiction in a variety of ways (e.g., denial of a deduction for specific expenses/equivalent upward adjustment)[32].

## 11. Final Remarks

The Two-Pillar Solution is a bold and long-awaited project that builds upon international consensus. The aim of the Two-Pillar Solution is clear and well grounded. However, the effectiveness and the consistent and harmonized application of the rules by the relevant MNEs is yet to be tested in the future.

At a first glance, the Two-Pillar Solution imposes a great deal of efforts on the relevant MNEs that involve not just the headquarters (which is likely staffed with experienced tax and compliance units), but also their local entities (which may not have the same level of experience and resources). Time will tell whether the complexity of the Two-Pillar Solution and the compliance duties that come along with it may affect the smooth application of the rules by the MNEs without causing them to suffer an excessive or unbearable administrative burden.

To date, Pillar 1 is undergoing several changes as a result of the public consultation (on Amount A) launched by the OECD. Further work is needed to render the measures more efficient in light of the aimed goal, i.e., ensuring that profits are taxed where economic activities take place and value is created. Moreover, work is progressing to develop the Multilateral Convention and its Explanatory Statement as well as the Model Rules for Domestic Legislation and related Commentary.

As far as the GloBE Rules are concerned, among others, pivotal issues are to be addressed in the future by the jurisdictions when implementing those rules. In particular, it would be important to clarify whether the US GILTI amounts to an equivalent set of rules on minimum taxation.[33]

Another aspect of the utmost importance concerns the interplay between GloBE Rules and the provisions of the tax treaties. Indeed, it is debated whether the GloBE Rules and the obligations arising therefrom are in line with the treaty provisions and limitations.

Furthermore, there is the risk that a formal approach based on a strict formula to determine GloBE liability may obliterate the granting of legitimate tax incentives provided by high-tax jurisdictions in connection with productive investments (e.g., Patent Box regime, R&D). As these types of incentives may lower the ETR, it may trigger GloBE liability that would neutralize the (legitimate) tax incentive.

31 Model Rules, Article 2.5. Model Rules, Art. 9.3. provides for a limitation to the UTPR when an in-scope MNE is in its initial phase of expanding abroad.

32 Model Rules, Article 2.4.

33 It is envisaged that, in the future, the IF will establish conditions whereupon the GILTI regime will co-exist with the GloBE Rules, to ensure a level playing field. To date, however, the matter is still uncertain.

# Implementing BEPS 2.0 Measures in the Hong Kong SAR, China

TAM Tai-pang

***Abstract***: This article provides an overview of the principles and policies adopted by the Hong Kong Special Administrative Region of the People's Republic of China (Hong Kong) in implementing the Base Erosion and Profit Shifting (BEPS) 2.0 measures. It also argues that implementing the global minimum tax would not undermine Hong Kong's competitiveness and a minimum top-up tax in Hong Kong is the logical response measure to safeguard Hong Kong's taxing rights. Finally, the article comments that MNEs will find non-tax attributes of a jurisdiction to be of greater importance in the post-BEPS 2.0 era.

***Keywords***: Global minimum tax; Qualified Domestic Minimum Top-up Tax (QDMTT); Competitiveness; Taxing rights

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On 8 October 2021, the OECD/G20's Inclusive Framework on Base Erosion and Profit Shifting (BEPS) promulgated a Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (the Statement).[1] The Hong Kong Special Administrative Region of the People's Republic of China (Hong Kong) is one of the 137 Inclusive Framework members that have joined the Statement.

## 1. The Two-Pillar Solution

Pillar 1 aims to ensure a fairer distribution of profits and taxing rights among jurisdictions with respect to the largest and most profitable multinational enterprises (MNEs) by re-allocating some taxing rights over them from their home jurisdiction to the market jurisdictions where they have business activities and earn profits, regardless of whether they have a physical presence there. In-scope MNE

1 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-october-2021.pdf.

groups are those with global turnover above EUR20 billion and profitability above 10% (i.e., profit before tax/revenue). For in-scope MNE groups, 25% of profits in excess of 10% of revenue (i.e., Amount A) will be allocated to market jurisdictions where goods or services are used or consumed by applying detailed sourcing rules to specific categories of transactions.

Pillar 2 seeks to set a floor on tax competition on corporate income tax through the introduction of a global minimum corporate tax rate at 15%. It targets MNE groups with annual consolidated group revenue of EUR750 million or more.

Pillar 2 consists of (i) two interlocking domestic rules (together the Global Anti-Base Erosion (GloBE) Rules), i.e., an Income Inclusion Rule (IIR) and an Undertaxed Payment Rule (UTPR), and (ii) a treaty-based rule, i.e., the Subject to Tax Rule (STTR).

The IIR imposes a top-up tax on a parent entity in respect of the income of a foreign-controlled entity where that income is subject to tax at an effective tax rate (ETR) below the global minimum tax rate of 15%. The UTPR, which serves as a backstop to the IIR, provides a mechanism for making an adjustment in respect of any remaining top-up tax in relation to low-taxed profits that fall outside the scope of an IIR by denying deductions or making an equivalent adjustment. ETR is calculated on a jurisdictional basis using a common definition of covered taxes and a tax base determined by reference to financial accounting income with certain adjustments.

The STTR provides the source jurisdiction with a limited taxing right to bring the tax on certain related-party payments, such as interest and royalties, up to the minimum rate (which is 9% for this purpose) where the payments are subject to tax in the other jurisdiction at an adjusted nominal rate below the minimum rate.

The Statement set out a detailed implementation plan for the two pillars. Amount A will be implemented through a multilateral convention to be developed and opened for signature in 2022, with Amount A coming into effect in 2023. Pillar 2 is to be brought into law in 2022, to be effective in 2023, with the UTPR coming into effect in 2024.

On 20 December 2021, the Inclusive Framework released the GloBE Model Rules.[2] Among other things, the Model Rules provide for a Qualified Domestic Minimum Top-up Tax, which in essence is a minimum tax implemented under domestic laws and operates to achieve outcomes consistent with the GloBE Rules. It will be credited against the top-up tax that may otherwise be chargeable under the GloBE Rules and payable in other jurisdictions. The effect of such a tax is to enable a jurisdiction to collect the top-up tax on the low-taxed profits in that jurisdiction instead of allowing other jurisdictions to collect it under the GloBE Rules.

Furthermore, under the Model Rules, total UTPR top-up tax is allocated to all jurisdictions in which the MNE group has Constituent Entities and which have a qualified UTPR in force. Allocation is based on the net book value of tangible assets and the number of employees in each of the UTPR jurisdictions. In contrast to the Blueprint for Pillar 2 published by the Inclusive Framework in October 2020, the allocation of UTPR top-up tax to a Constituent Entity is no longer restricted by the amount of intra-group payments.

Commentary and examples for the Model Rules were released by the Inclusive Framework on 14 March 2022.

## 2. Hong Kong's Response

The Financial Secretary affirmed in his

2 OECD (2021). *Tax Challenges Arising from the Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two)*, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.pdf.

2021-22 Budget Speech that Hong Kong will actively implement the BEPS 2.0 proposals according to international consensus.[3] Earlier on, an Advisory Panel on BEPS 2.0 was set up in June 2020 to review the possible impact of the latest requirements under BEPS 2.0 on the competitiveness of Hong Kong's business environment and to advise the Financial Secretary on strategies and measures to facilitate the sustainable development of Hong Kong as an international financial, trading and business centre in light of the changing international tax landscape.

In its recommendations made in December 2021,[4] the Advisory Panel assessed that Pillar 1 would unlikely have a significant impact on businesses operating in Hong Kong given the limited number of Hong Kong-headquartered in-scope MNE groups. The Advisory Panel recommended, however, that Hong Kong should implement Pillar 1 by adhering to the tax framework endorsed by the international community and by participating in the new multilateral convention, as this would help affected businesses eliminate double taxation and reduce compliance costs.

For Pillar 2, the Advisory Panel recommended that Hong Kong should amend its existing tax regime to apply in full the GloBE Rules stipulated by the OECD to implement the global minimum tax, and the relevant amendment should only apply to in-scope MNE groups with ETR below the minimum tax rate.

The Advisory Panel further recommended that the Government should protect Hong Kong's taxing rights and minimise the compliance burden of businesses operating in Hong Kong.

Regarding the STTR, the Advisory Panel recommended that Hong Kong should accept requests for the inclusion of the rule in its existing and future tax agreements with developing economies.

In his 2022-23 Budget Speech, the Financial Secretary stated that the Government will submit a legislative proposal to the Legislative Council in the second half of the year 2022 to implement the global minimum tax rate and other relevant requirements in accordance with the international consensus. He further indicated that the Government will consider introducing a minimum top-up tax with regard to in-scope MNE groups starting from the year of assessment 2024-25 to safeguard Hong Kong's taxing rights.[5]

## 3. Minimum Top-up Tax for Hong Kong

The mere implementation of the GloBE Rules would not be sufficient to protect Hong Kong's taxing rights under BEPS 2.0. Hong Kong may not be able to impose a top-up tax on all low-taxed profits of in-scope MNE groups' Constituent Entities in Hong Kong and such profits may still be subject to the IIR (for foreign-headquartered MNE groups) or the UTPR (for both Hong Kong- and foreign-headquartered MNE groups) in other jurisdictions. The logical response measure is to introduce a minimun top-up tax in Hong Kong that is consistent with the GloBE Rules to prevent the application of the IIR or UTPR by other jurisdictions in respect of the low-taxed profits of in-scope MNE groups' Constituent Entities in Hong Kong. In other words, if top-up tax is to be paid on such profits, it will be collected by the Hong Kong Government instead of foreign jurisdictions. This will safeguard Hong Kong's taxing rights

3 *The 2021-22 Budget, International Tax Co-operation*, https://www.budget.gov.hk/2021/eng/budget58.html.

4 Financial Services and the Treasury Bureau, Hong Kong (2021). *Recommendations of the Advisory Panel on BEPS 2.0*, https://www.fstb.gov.hk/tb/en/others/publications.htm.

5 *The 2022-23 Budget, New International Tax Standards*, https://www.budget.gov.hk/2022/eng/budget85.html.

on profits of Hong Kong Constituent Entities. It is noted that a number of jurisdictions are considering the introduction of a domestic minimum top-up tax in their tax regimes to protect their taxing rights on local low-taxed profits.

The introduction of a minimun top-up tax in Hong Kong could also significantly reduce the compliance burdens of in-scope MNE groups as they would not be liable to top-up tax under the UTPR in multiple jurisdictions in respect of their low-taxed profits in Hong Kong.

## 4. Competitiveness

There are concerns that implementing the GloBE Rules and a minimun top-up tax in Hong Kong may undermine Hong Kong's competitiveness. In this connection, it should be noted that given the comprehensive nature of the GloBE Rules, top-up tax on low-taxed profits of in-scope MNE groups would have to be paid somewhere. Specifically, the latest design of the UTPR means that there will hardly be any room for in-scope MNEs to minimise their UTPR top-up tax by restructuring their intra-group payments. Besides, the absence of a minimum top-up tax in Hong Kong would simply mean ceding Hong Kong's taxing rights to other jurisdictions without bringing any real benefits to the MNE groups concerned in terms of tax savings. It is also anticipated that many jurisdictions would introduce a domestic minimum top-up tax to protect their taxing rights. On the whole, it is not considered that the implementation of the GloBE Rules and a minimun top-up tax in Hong Kong would have adverse impact on Hong Kong's competitiveness. Rather, the adoption of a global minimum tax rate would provide a more level playing field among jurisdictions.

While changes will be made to Hong Kong's tax regime to implement the BEPS 2.0 measures, the Financial Secretary has reassured that Hong Kong will preserve the simplicity, certainty, transparency, and fairness of its tax system and maintain the territorial principle of taxation. The Government will also strive to minimise the compliance burden of in-scope MNEs when implementing BEPS 2.0 and has been communicating with affected MNEs to gauge their views and to enable them to get familiarised with the new tax rules. Finally, small and medium-sized enterprises will generally not be affected by the measures.[6]

It is expected that in the post-BEPS 2.0 era, non-tax attributes of a jurisdiction will assume more importance in an MNE's decision on locating its business activities. On this front, with its sound legal system, first-class professional services sector, well-established capital markets, the unique advantage of "one country, two systems", and the opportunities arising from the Belt and Road Initiative and the Greater Bay Area development, Hong Kong is an attractive and ideal location for MNE groups to establish and maintain their businesses. The Government will continue to engage members from various sectors on strategies and measures to enhance Hong Kong's business environment and competitiveness in a holistic manner.

## 5. Concluding Remarks

The timeline set by the Inclusive Framework for the implementation of the BEPS 2.0 measures is no doubt an ambitious one. At the time of writing, the multilateral convention and model provisions for Amount A, and the model treaty provisions and the multilateral instrument for the STTR are still being developed. In addition, it will be a great challenge to put in place the required legislation in Hong Kong in time. As mentioned above, Hong Kong will continue with the preparation while following closely developments in the international arena.

6 See note 3 (at paragraph 179) and note 5 (at paragraphs 187 and 188) above.

# Implications of the Interaction of Trade and Tax Rules (Part One)

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***Abstract***: Trade, investment and tax treaties are concluded for different reasons and with different objectives. The international trade and tax systems are overseen by different global organizations. The overlaps and inconsistencies between these agreements could be exploited by investors to gain unintended advantages. Therefore, developing countries must ensure that there is greater cooperation and exchange of information in relation to trade, investment and tax policy.

The exchange of information between tax administrations is important in the context of the Belt and Road Initiative (BRI), where the tax administration in each jurisdiction needs to know more about the cross-border transactions of multinationals operating in its territory. The most effective way for developing countries to improve the exchange of information is to sign multilateral agreements, in particular the Convention on Mutual Assistance in Tax Matters.

The customs and transfer pricing functions within a jurisdiction should collaborate and exchange information to ensure that the pricing of import transactions is consistent across different taxes. Both functions could carry out risk-based compliance audits that would involve comparison of transfer pricing and customs documentation. In the context of coordination between customs and direct tax functions, the comparison of customs and transfer pricing documentation can be established on a routine basis. Closer coordination of transfer pricing and customs would also help

taxpayers reduce compliance costs in relation to cross-border transactions. In view of the compliance costs involved in putting together transfer pricing documentation, it would help taxpayers if much of the same documentation could also be used for the purposes of customs valuation.

***Keywords***: Investment treaty; Double tax agreement; Customs duties; World Trade Organisation; Tax administration; Transfer pricing; Developing countries

## 1. Introduction

Rules to regulate trade and investment are essential to ensure that cross-border transactions can be carried out according to consistent standards, with dispute resolution available when a dispute arises between two parties.

Problems can arise when two or more sets of rules have conflicting requirements and the correct procedures to follow are not well defined. There are different sets of rules in relation to tax, trade and investment, regulated by different international bodies in addition to other rules agreed among regional blocs of jurisdictions. The scope of the different sets of rules may overlap, creating uncertainty.

For this reason, developing countries, in particular, must ensure that there is greater cooperation and exchange of information between them in relation to trade, investment and tax policy. Better defined rules can save resources for governments and bring benefit to investors through reduced compliance costs and more certainty.

In addition, different agencies within the government can coordinate their activities, resulting in cost savings and more opportunities to detect breaches of the trade and tax rules.

## 2. Trade Rules and Their Interaction

### 2.1 Overview of Global Trade Rules

The WTO/GATT agreements affect a broad range of issues in relation to international trade. These agreements outline general trading rules but can also affect direct and indirect taxation. An example of this is the "national treatment" rule under GATT Art. III (National Treatment on Internal Taxation and Regulation).[1] This rule applies to counter the use of taxation as a form of protection for the domestic market, by ensuring that the treatment given to imported products should be no less favourable than that applied to domestic products, and can apply to a wide range of taxes and duties.

The WTO/GATT agreements can have an important effect on customs duty rates and quotas, for example through their role in facilitating customs dispute resolution. The Agreement on Subsidies and Countervailing Measures (SCM Agreement) deals with the provision of subsidies and the use of countervailing measures in case of harm caused by subsidized imports. A "specific subsidy" may be subject to countervailing measures. The agreement defines a subsidy as a financial contribution made by a government or any public body to confer a benefit within its territory. The SCM Agreement sets out the types of measures that could represent a financial contribution and could therefore constitute a subsidy. These measures include grants, loans, equity infusions, loan guarantees, fiscal incentives, the provision of goods or services or the purchase of goods.

The SCM Agreement applies to measures taken by national governments, sub-national governments and public bodies such as state-owned companies. The agreement would encompass tax incentives in a very broad definition of subsidies, but would only prohibit them

1 WTO (2012). *Part II Article III, National Treatment on Internal Taxation and Regulation*, https://www.wto.org/english/res_e/publications_e/ai17_e/gatt1994_art3_gatt47.pdf.

if they are contingent on export performance. A prohibited export subsidy would be a subsidy that is "tied" to actual or anticipated exportation.

The WTO/GATT agreements also provides for most-favoured nation (MFN) treatment, which is intended to ensure the parity of treatment among WTO members. This central principle of the multilateral trading system aims to eliminate power-based, unequal trading relations with a rules-based framework in which trading rights are not based on the economic or political power of a jurisdiction but where the best conditions that have been conceded to one jurisdiction for access to trade must automatically be extended to all other jurisdictions participating in the system. In this way all the participants benefit from concessions agreed between large members that have more negotiating power.

The General Agreement on Trade in Services (GATS) established the framework of rules to regulate trade in services. The GATS agreement established procedures by which members commit to liberalising trade in services and also set up a dispute resolution mechanism. Under Article IV of the GATS, members are required to negotiate specific commitments in relation to strengthening developing countries' domestic services capacity, improving access by developing countries to distribution channels and information networks, and liberalising market access in areas affecting exports of developing countries.

The liberalisation of services under the GATS agreement should be carried out with consideration for national policy objectives and the level of development of the members. Developing countries are given flexibility to initially open up fewer service sectors and later to gradually extend market access as their level of development may allow. Developing countries are also given the right to access technical assistance arranged by the WTO Secretariat.

### 2.2 Interaction between Different Trade Sets of Trade Rules

In addition to the WTO/GATT agreements which cover a broad range of trade issues, there are also regional trade agreements such as those concluded by Mercosur, Association of Southeast Asian Nations (ASEAN) and the European Union. These regional agreements create a further layer of trade rules that may conflict with global rules in some cases. Agreements between regional groupings could further complicate this position.

Agreements are also signed between individual countries and regional trading blocs, for example the agreements made by ASEAN with China and with Australia. The European Union has also concluded some agreements with single countries. Although these agreements are generally less broad in scope than the arrangements within regional blocs, they add further complexity to the trading rules.

In addition to free trade agreements (FTAs) that include provisions to reduce customs duties between the signatories, governments may also conclude Memoranda of Understanding (MOUs), Memoranda of Arrangement (MOA) or framework agreements. Cooperation between countries/regions may also be set out in joint communiques or guiding principles. These various types of agreements may create interlocking obligations that can give rise to challenges and disputes.

Countries/regions need to consider these different layers of trading rules and address their interaction with other cross-border arrangements for investment protection and taxation. Approaches must be developed to achieve some coordination in these networks of interlocking and sometimes overlapping arrangements.[2]

2 Jeffrey Owens & Hafiz Choudhury. *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.

## 3. Tax Rules and Interaction with Trade Agreements

### 3.1 Trade Rules and Indirect Tax

When countries/regions agree to form regional trading blocs, difficulties can arise from the interaction of trade rules and indirect tax. Regional groupings of jurisdictions aim to introduce a measure of economic integration, for example a customs union. Some regional trading blocs have also implemented a strategy for a common framework on indirect taxes, examples being the European Union and the Gulf Co-operation Council which have outlined general VAT rules for their member states, subject to implementation in national laws.

The next step after forming a customs union may be harmonisation of rules on indirect tax, as indirect taxes are often charged at the point of entry of goods into a jurisdiction. Harmonisation of indirect tax rules in addition to customs duties on imports may bring further advantages through simplification and rationalisation of customs procedures and valuations.

### 3.2 Transfer Pricing and Customs Valuations

Transfer pricing rules for direct tax purposes and customs valuation for customs duty purposes both concern the valuation of cross-border transactions, but there are two different sets of rules overseen by different international bodies. The OECD has drawn up the transfer pricing guidelines that are the widely accepted standard for establishing the price of cross-border transactions for tax purposes, while the WTO's Customs Valuation Agreement sets out rules concerning customs valuation. In many countries the direct tax and customs issues are dealt with by two different government departments, although there has been a move to combine these or to introduce greater coordination.

The existence of two separate sets of rules creates additional compliance costs for enterprises. There would be administrative advantages and cost savings from having a single set of rules backed up by one set of documentation. Various ideas have been put forward to harmonise the rules.

However, there are practical problems with combining the two sets of rules. They exist for different reasons, and while customs duties are concerned with a transaction in goods at one point in time, the transfer pricing rules are part of the direct tax system. The latter looks at the taxable profit for an accounting or tax period, using profit methods if necessary, as an alternative to the traditional transactional methods for pricing transactions. Customs officials collect duties based on the customs valuation, and will be looking for any indication that the valuation is understated. A transfer pricing auditor is more likely to be looking for signs that the cross-border transaction price has been overstated by the company with the objective of increasing the cost of goods sold and therefore reducing the profit for direct tax purposes.[3]

Therefore, there is an inherent tension between administration of the customs rules and transfer pricing regimes. Both sets of rules are concerned to ensure that the price or valuation is not influenced by the relationship between the parties, and rules are therefore applied to establish an arm's length price. However, the objectives, calculation methods and documentation requirements are different and difficult to harmonise.

Transfer pricing documentation requirements are more detailed and require documentation of a much broader nature, including the economic circumstances and the industry in which the group operates, details of the oper-

3 Liu Ping & Caroline Silberztein (2008). Transfer Pricing, Customs Duties and VAT Rules: Can We Bridge the Gap? 6 *Tax Planning International Indirect Taxes*, pp. 7.

ations of the group, the taxpayer's related party transactions, a comparability analysis, and the choice of transfer pricing method. There are also problems in relation to the treatment of intangible assets and services. Transactions involving intangibles and services would generally affect customs valuations only where they are closely related to a transaction in goods.

Some steps can be taken by tax authorities to use the available information in a way that can save compliance costs for business. Improving the flow of information between customs and revenue authorities could help to highlight any inconsistencies in valuation and assist in risk assessment. Joint audits by customs and direct tax authorities are also a possibility.

More progress could be made on harmonising the documentation used for related party transactions. Detailed documentation is prepared for transfer pricing purposes, and this could be accessed by customs authorities to assist in their valuations, keeping in mind the different objectives of transfer pricing and customs valuations. If the transfer pricing documentation includes adequate information for customs purposes, this could save compliance time and costs for the taxpayer. Difficulties would still arise from the difference in timing of the preparation of transfer pricing and customs documentation and the differences in the relevant rules.

Costs could also be saved by a combined approach to dispute resolution. Joint dispute resolution mechanisms would be a logical continuation from the idea of joint audits and would benefit from the greater amount of information available from the two sets of documentation.

Developing countries may encounter difficulties in implementing these possibilities owing to the restraints of administrative capacity. Further capacity building is necessary before some of these projects could be implemented. Input from the relevant international organisations such as the OECD, UN, WTO and the World Customs Organisation would therefore be useful in assisting the process of greater coordination between transfer pricing and customs.

### 3.3 Trading Agreements and Direct Tax on Services and Intangibles

The GATS agreement does not affect tax issues to the same extent as other WTO/GATT agreements can affect taxation in relation to cross-border trade in goods. Generally, direct and indirect taxation of cross-border services is subject to the provisions of domestic tax legislation and to the provisions of double tax treaties as regards the existence of a permanent establishment (service PE) and the application of business taxation. The range of trade agreements and their impact on services and intangibles is detailed in the earlier paper cited above.[4]

(To be continued)

4 Owens and Choudhury, *op. cit*.

# Benefits Realization Management Framework to Ensure the Creation and Timely Delivery of Public Value in Uruguay

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***Abstract***: The aim of this article is to share the experience in enhancing tax administration capacity building to manage benefits realization. In 2020 the Uruguayan Tax Administration implemented the Benefits Realization Management framework through the application of the DGI Business Case Preparation Methodology and the DGI Benefits Management General Methodology. This article describes the main characteristics of both methodologies, their implementation process, the results obtained, and the actions that have been planned to be carried out to consolidate such practices in the organization. It also analyzes the relationship between benefits realization, organizational strategy, portfolio management, and public value creation.

***Keywords***: Benefit Realization Management; Business Case; Tax administration; Public value

## 1. Background

DGI[1], the Uruguayan Tax Administration, pursues to produce public value for the State and the Society. To create public value, DGI carries out a results-based management approach. This management model seeks to ensure that the processes, products and services contribute to the achievement of clearly defined outcomes. To develop this management model, it is necessary to implement a strategic planning process, set up objectives, metrics and measurable goals that make it possible to evaluate those outcomes.

Strategic planning is a fundamental tool for aligning priorities in the applica-

1 DGI, as per the Spanish abbreviation, Dirección General Impositiva.

tion of limited resources and establishing criteria for management control. However, making the organizational strategy effective in a public organization is a complex matter. This requires, in the first place, to institutionalize the strategic planning process, and then it is essential to be efficient in managing multiple projects as an integrated entity. Furthermore, it must be ensured that these projects effectively generate public value.

DGI consolidated the strategic planning process and generated the capacity to execute projects efficiently. However, it faces the challenge of ensuring that the projects' expected benefits are captured as soon as possible and at the desired level. To meet this challenge, DGI is implementing the Benefits Realization Management framework (hereinafter referred to as "BRM framework").

The following describes what BRM is, the reasons to implement the BRM framework in DGI, the steps taken for its implementation, the results obtained, and what remains to be done to firmly consolidate this practice in the organization.

## 2. Opportunities and Challenges

Facing a complex and dynamic context, characterized by increasingly rapid changes in the Tax Administration business, limited resources, changing tax regulations and increased demands for transparency and compliance, DGI must ensure that the investment in portfolio, programs, or projects is directed to obtain clear and sustainable benefits. Nonetheless, often there is a gap between the benefits planned and those realized.

To guarantee that expected benefits of one project are captured, usually the organization should carry out a series of actions which have not necessarily been identified as part of the project scope. Those actions will be defined according to the BRM framework, addressing the difficulties associated with the realization of benefits, as well as those linked to the management of changes that could affect the organization, the project, or the defined benefits.

The BRM framework is defined as "*a set of integrated governance and management practices designed to define, develop, realize, and sustain planned benefits*".[2] Value and benefit are not interchangeable concepts. A benefit is considered as *"a gain realized by the organization and beneficiaries through portfolio, program or project outputs and resulting outcomes*",[3] meanwhile, value *"is the net result of realized benefits less the cost of achieving these benefits"*.[4] Benefits can be tangible or intangible. Many of the benefits produced by public organizations such as Tax Administrations are of an intangible nature; these are also considered by the BRM framework.

Then, organizational objectives are achieved by managing business initiatives, from which portfolios, programs and projects are executed to deliver outputs, which result in outcomes. Those outcomes produce benefits that ultimately deliver the value sought by the organization (see Figure 1).

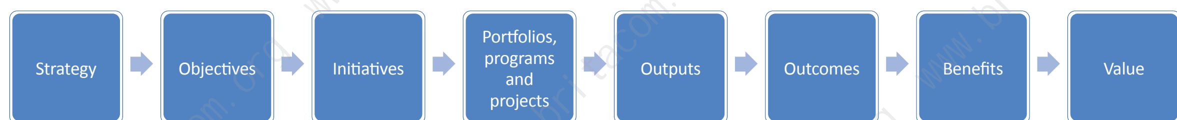


Figure 1. Relationship between BRM and organizational strategy
Source: The author's study based on Project Management Institute, Inc. (2019), pp. 9.

2 Project Management Institute, Inc. (2019). *Benefits Realization Management: A Practice Guide*. Pennsylvania: Project Management Institute, Inc., pp. 84.

3 Ibid.

4 Ibid, pp.7.

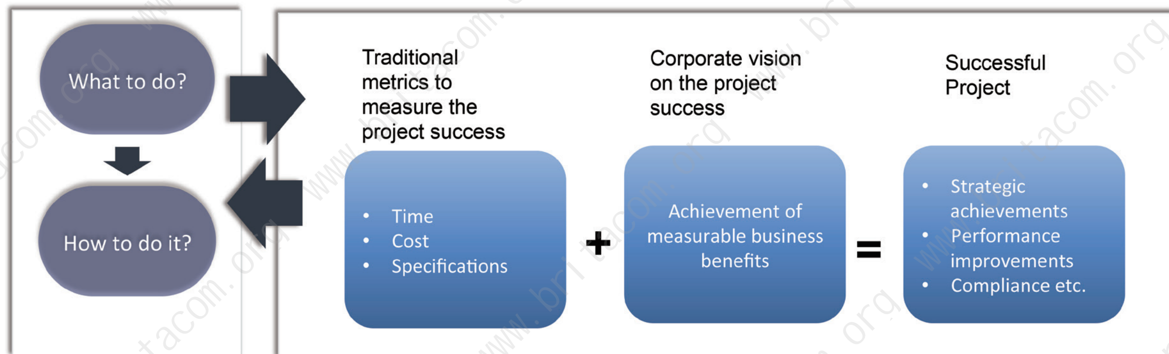


Figure 2. Successful project definition
Source: The author's study based on Dirección General Impositiva (2020c).

The actions needed to ensure benefits realization could be developed during the project execution, and once it is completed, in the post-implementation stage. In addition, it could be needed to address issues related to the operating model defined for the project products exploitation. It should be considered that even when the expected project deliverables are obtained in a timely manner, if the operating model in which the project products will be used has not been correctly defined, problems may arise and benefits realization can be negatively impacted. In this case, the failure would not be attributable to the products defects but would probably derive from an error in the post-implementation operation planning, or even in the expected benefits identification.

## 2.1 When Is a Project Successful?

A project will be considered successful if it generates the expected outputs in a timely manner and its planned benefits are realized. This implies that neither the projects nor the outputs generated by them constitute a goal in itself, but rather are means to achieve certain expected benefits. Those benefits must be defined at the business level, in a BRM Plan.

A successful project definition (see Figure 2):

- Guarantees the alignment between the projects and the strategy;
- Maximizes the value;
- Focuses the discussion on "what to do", over on "how to do it";
- Optimizes resource allocation;
- Links customer needs to specific benefits; and
- Has quality information to support decision-making on the Portfolio.

## 2.2 How Is BRM Related to Business Case and Portfolio Management?

A Business Case is defined as *"a documented economic feasibility study used to establish the validity of the benefits of a selected component lacking sufficient definition and used as a basis for the authorization of further project management activities"*.[5] This is a key tool to identify which initiative generates the greatest benefits, and based on that, priorities can be established considering their value for the business and their alignment with the strategic plan.

A Business Case is also one of the outputs of the Business Analysis process. A Business Analysis is defined as *"a set of activities performed to identify business needs; recommend relevant solutions; and*

5 Project Management Institute, Inc. (2015). *Business Analysis for Practitioners: A Practice Guide*. Pennsylvania: Project Management Institute, Inc. pp. 184.

*elicit, document, and manage requirements"*.[6] This practice is used to assess the potential benefits of a business proposal, and its associated costs and risks, in order to determine its relevance. It also provides a guide on how to document the main aspects that were considered when conducting the business analysis, facilitating the systematic sharing of this information.

The Business Case is useful when the decision-makers need to:

- Analyze how to implement the strategy at the corporate or divisional level;
- Determine if a venture will be beneficial for an organization;
- Determine the best alternative to achieve a strategic objective;
- Find a solution to a business problem; and
- Understand the costs/efforts that carrying out an enterprise implies.

Once the Business Case has been prepared and approved by the authority who promotes the initiative, it will be submitted for evaluation. To assess the Business Case the management team considers, among other elements, the cost-benefit ratio and the alignment with the strategy. If it is selected to be implemented, it will be assessed considering other projects that integrate the portfolio, and other selected business cases. It should also be noted that profitability will not always be available as a decision factor. Therefore, it will be necessary to evaluate on the basis of intangible benefits that are not easily quantifiable, for instance:

- Human Capital: skills, knowledge, and values;
- Organizational Capital: culture, leadership, alignment, and teamwork;
- Information Capital: quality of information;
- Institutional Image; and
- Compliance: legal, regulatory, etc.

It could happen that a Business Case which shows an excellent cost-benefit ratio was not selected because it is not the right time for its implementation, either due to the defined strategy or another circumstance that the organization is going through. In addition, the priority in its integration into the Portfolio will also depend on its comparison with other Business Cases against which it must compete for limited resources.

Once the Business Case is selected and prioritized, it is integrated into the Portfolio. Then, the initiation of the project or program required for its implementation is authorized. Resources are then allocated and the project planning stage begins.

The selected and prioritized Business Case is also the main source of information for preparing the BRM Plan. The BRM Plan describes planned activities, time frameworks, and criteria to consider that one or more planned benefits are achieved.

After the Business Case approval, it is necessary to keep it updated considering possible events that affect the project and its benefits. Additionally, if changes occur in the organization or in its context, in the projects involved or in its implementation process, these factors could also affect the Business Case.

Once the Program or Project associated with the Business Case has ended or the predefined timeline for starting BRM evaluation has completed, it must be verified whether the expected benefits were achieved and to what extent. If the expected benefits are achieved, the change cycle will be successfully completed, and the Business Case will be closed (see Figure 3). If, on the contrary, the expected benefits are not achieved, two courses of action will be opened.

On the one hand, if it is considered that there is still time to achieve the benefits, the evaluation period will be extended, adjusting the BRM Plan accordingly. On the other hand, if it is concluded that the expected benefits will not be achieved, the Business Case must be closed, recording the reasons for the benefits realization failure. By applying this procedure,

6 Ibid.

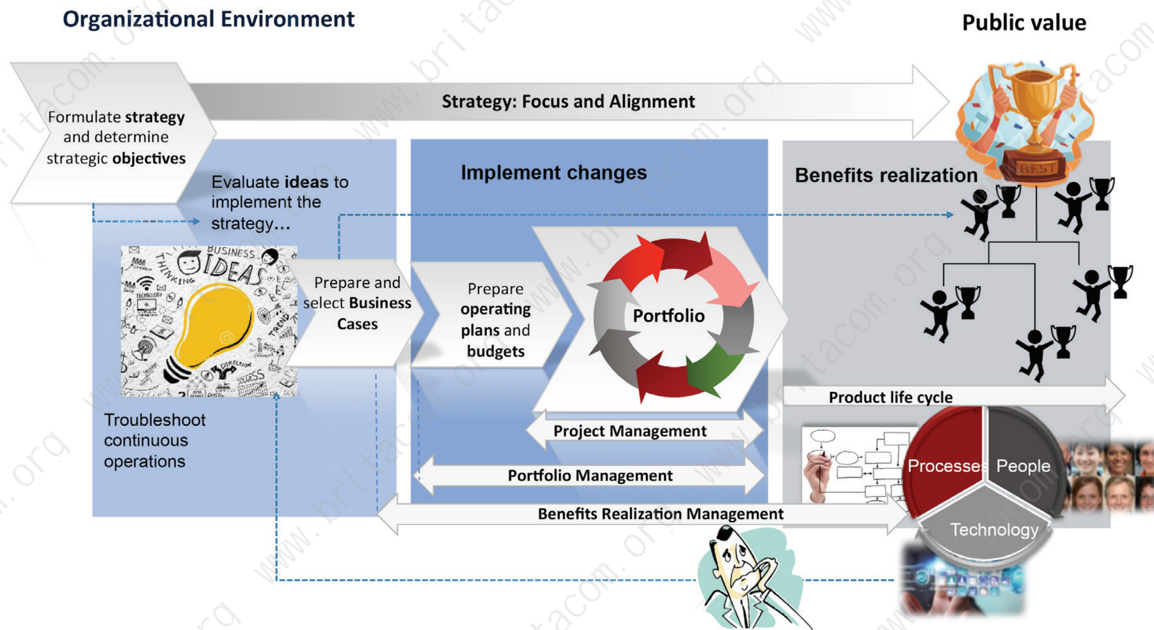


Figure 3. Relationship among Business Case, Benefits Realization Management, Portfolio Management and Public Value
Source: The author's study based on Dirección General Impositiva (2020d).

lessons learned are recorded to generate organizational knowledge.

## 3. Practice and Progress Achieved on BRM Implementation

### 3.1 BRM Implementation Project

In 2020 DGI implemented the BRM framework through the application of two methodologies; the DGI Business Case Preparation Methodology (hereinafter referred to as "DGI BC methodology") and the DGI Benefits Management General Methodology (hereinafter referred to as "DGI BMG methodology").

The DGI BC methodology establishes the framework in which the organization manages the processes of formulating, selecting, prioritizing, evaluating, and closing Business Cases. Meanwhile, the DGI BMG methodology establishes the organizational framework to manage BRM.

To implement BRM, DGI relied on the advice of an expert consultant with proven experience in implementing this practice in public organizations. Advised by the expert, a team integrated by DGI planning area officials worked in the project execution from August to December 2020 as follows:

(i) Initiation: During this stage, the objectives, scope, approach and schedule of the BRM implementation project were defined, and the stakeholders were identified. Subsequently, the work plan was presented to the DGI General Directorate for its approval.

(ii) Design: Once the plan was approved, the BC and the BMG methodologies were designed, and the training plan was prepared.

(iii) Implementation: In this stage, the training plan was executed, and to practice the methodologies application, BRM plans were prepared for a subset of projects in execution.

The outputs delivered by this project were the formal implementation of the DGI BC and the BMG methodologies, as well as the training

of 59 officials from strategic, operational planning and projects areas.

## 3.2 Integrating the Practice into the Organization Operating Model

In 2021, the annual operating plan was formulated with both methodologies integrated into the operating model. This involved requiring Business Cases to evaluate new initiatives to be considered for inclusion in the portfolio, as well as defining a BRM plan for each of the 28 projects included in the DGI Annual Operating Plan 2021 (POA 2021).

### 3.2.1 Main aspects of the DGI BC methodology

This methodology establishes the process for preparing and selecting Business Cases to be implemented, as well as the governance structure and the roles and responsibilities of those involved in such process. Additionally, it contains a business case template that provides a structure for researching and presenting a clear and comprehensive document, and general guidelines for risk analysis. Table 1 shows a summary of the process and the governance defined to be applied in DGI.

**Table 1: A summary of the process and the governance of the DGI BC methodology**

| Governance: Roles, functions, and responsibilities | Process | |
|---|---|---|
| | Stage 1: Business Case Formulation | Stage 2: Selection and prioritization |
| Business Case Owner: Organizational area Director who promotes the initiative/change | Responsible for the Business Case preparation and approval | Responsible for presenting the Business Case for evaluation, explaining, and adjusting it if necessary |
| Operational Planning areas | Responsible for conducting the business analysis and documenting the Business Case | |
| DGI Management Team | | Responsible for the portfolio management: Evaluates, selects and prioritizes the Business Case, and approves the project initiation |
| Planning and Management Control Department | Responsible for providing methodological advice: Advises and trains those who formulate the Business Cases | Responsible for advising both the Business Case Owner and the DGI Management Team |
| Processes and Procedures Organization and Coordination Department | Provides technical advice in business analysis | Provides technical advice in business analysis |

Source: The author's study based on Dirección General Impositiva (2020a).

### 3.2.2 Main aspects of the DGI BMG methodology

This methodology establishes the process for collecting information, preparing the BRM plan, controlling and reporting metrics and benefits, as well as the governance structure and the roles and responsibilities of those involved in such process. Additionally, it contains a BRM plan template that provides a structure for researching and presenting a clear and comprehensive document, and general guidelines for risk analysis. Table 2 shows a summary of the process and the governance defined to be applied in DGI.

**Table 2: A summary of the process and the governance of the DGI BMG methodology**

| Governance: Roles, functions, and responsibilities | Benefits Management | | |
|---|---|---|---|
| | Stage 1 — Information collection and validation | Stage 2 — Development of the BRM plan | Stage 3 — Monitoring, control and reporting of metrics and benefits |
| Business Case Owner: Organizational area Director who promotes the initiative/change | Responsible for ensuring the availability of adequate, sufficient, and accurate information to support the plan | Responsible for the BRM plan formulation | Responsible for the execution of the BRM plan |
| Benefit Owner: Is responsible for the process or service that will be directly favored by obtaining the benefit, and in general, is the organizational area Director that will receive the benefit | Provides information regarding the benefit, and how it can be achieved and measured | Collaborates in the BRM plan formulation, especially regarding how it is planned to be captured and measured | Collaborates in measuring the benefits realization if it is requested |
| Sponsor: Refers to the role defined according to the DGI Project Management practices | Responsible for ensuring the availability of adequate, sufficient, and truthful information about the project benefit expected | Collaborates in case it is required | Collaborates in measuring benefits during the project |
| Project Manager: Refers to the official designated to coordinate the project | Provides information regarding the project; mainly during Initiation and Planning stages | Provides information for the development of BRM plan during the project if it is requested | Provides information about metrics definition and measurement during the project, if it is requested |
| Project Team: Refers to the team designated to execute the project associated with the benefits planned | | Provides information for the development of BRM plan during the project if it is requested | Collaborates in monitoring the execution of the BRM plan during the project |
| Benefits Management Team: Refers to the team appointed by the Benefit Owner and/or the Business Case Owner to measure the benefits realized | | Collaborates in the BRM plan preparation if it is requested | Monitors the BRM plan during and after the project |
| Planning and Management Control Department | Provides mentoring | Provides mentoring and training | Provides mentoring and training |
| DGI Management Team | | Receives the BRM plan | Approves the BRM plan evaluation report and the Business Case closure |

Source: The author's study based on Dirección General Impositiva (2020b).

### 3.3 Critical Success Factors

During the BRM implementation, the following key factors to successfully advance in the process have been highlighted:

- Support from authorities: Successful adoption of BRM depends on support from executive leadership, sponsors, and benefit owners.
- Tailoring: There are different standards of BRM practices available; however, which ones the organization chooses to implement will depend on its specific structure, culture, and regulations. Standardized practices must always be adapted to each organization, prior to their application.
- Training and mentoring: Building capabilities through incremental steps requires balancing methodologies sophistication and staff capabilities. For this, continuous training and a strong mentoring function are essential.
- Governance: BRM requires a clear governance structure under which those responsible for managing and achieving the expected benefits are properly identified as accountable. For each benefit planning, monitoring and evaluation cycle, the roles and responsibilities of those involved in the process should be reinforced.
- Focus on benefits: It is necessary to change the successful project conception based on its deliverables and performance, as the successful project is based on its long-term results and its contribution to the business strategy. Focusing only on staying on schedule, without considering the impact on costs, quality,

benefits or results, should be avoided.

- Communication: It must be clear and relevant.

## 4. Achievements

Regarding the Business Case methodology application, the following results have been obtained as shown in Table 3.

Meanwhile, regarding the BRM methodology application, in 2021, 28 BRM plans were defined (100% of the portfolio). This involved developing several workshops to support each of the 28 project teams to formulate their respective BRM plan.

**Table 3: The results obtained from the Business Case methodology application**

| Year | Business Cases presented | Business Cases approved for implementation | New projects integrated into the portfolio | New projects integrated into the portfolio with a Business Case |
|---|---|---|---|---|
| 2021 | 4 | 2 | 12 | 2 |
| 2022 | 15 | 10 | 13 | 10 |

## 5. Future Outlook for Tax Capacity

In order to consolidate BRM in the organization, it is necessary to continue reinforcing the practice, and assessing, at planned intervals, the actual performance achieved against the criteria and metrics defined for the benefits realization. For this purpose, 15 BRM plans whose expected benefits would be generated in the period will be evaluated during the first semester of 2022. In addition, it is planned to review all BRM plans to verify their validity and updating, as well as to formulate BRM plans for all the new projects that have recently been integrated into the portfolio.

In relation to the BRM framework implementation, by 2024 the DGI intends to achieve two goals: 80% of projects with defined BRM plans and 80% of projects with expected benefits realized.

By strengthening its processes for managing portfolios, programs, projects and benefits realization, the Uruguayan Tax Administration will increase its capability to produce value for the State and the Society.

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# Transfer Pricing Regulations of Armenia

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***Abstract***: The current transfer pricing (TP) legislation of Armenia was elaborated back in 2014-2015 and the Tax Code with a special TP chapter in it (Chapter 73) was adopted in 2016. The provisions of 2016 Tax Code came into force in 2018, but the implementation of the TP regulations came into force on 1 January 2020. Currently, the legal framework of TP regulations is not complete for conducting tax administration. In this regard, in early 2021, a project on amending TP regulations was proposed, which has been already effective since 13 April 2022. This paper will discuss the five biggest issues of the current TP regulations and the proposed amendments and additions to the TP rules as solutions to those issues, which would help to effectively conduct tax administration.

***Keywords***: Transfer pricing; Tax administration; BEPS project

## 1. Background on Armenian Transfer Pricing Regulations

Back in 2011, the introduction of transfer pricing (TP) regulations as a separate law was discussed in the National Assembly of Armenia (the Parliament). Also, discussions were held to adopt a new Tax Code. Hence, it was decided to include the TP regulations in the upcoming Tax Code, which was adopted in 2016. The provisions of 2016 Tax Code came into force in 2018, but the implementation of the TP regulations was not yet well-prepared, hence it was decided that the TP regulations would come into effect starting from 1 January 2020.

Nevertheless, the current legal framework of TP regulations is still not complete for conducting tax administration. In this regard, a project on amending TP regulations was proposed in early 2021, the outcome of which became effective on 13 April 2022.

This paper discusses the five biggest issues of the current TP regulations and the proposed amendments and additions which will facilitate the conduction of tax administration.

## 2. The Five Biggest Issues in TP Regulations

Based on the OECD TP Guidelines, the current TP regulations of Armenia are

far from complete. Compared with international best practices, Armenian TP regulations lack several important provisions, making it problematic to conduct tax administration and ensure tax compliance.

### 2.1 Issue No. 1

According to the Armenian Tax Code, the TP regulations are applied to profit tax, VAT and royalties paid for the extraction of natural resources. It is quite problematic to include VAT transactions in the TP regulations for two reasons. Firstly, most countries do not include VAT transactions in their TP regulations, as it could cause difficulties in tax administration. Secondly, taking into account some peculiarities of the Armenian Tax Code concerning VAT exemptions, possible difficulties may arise during TP audits. For instance, an NGO, which is entitled to a VAT exemption, receives a grant from its non-resident related party for an amount of AMD200 million (Armenian dram) in a reporting period. This transaction may be controversial during a TP audit, because Article 363 of the Armenian Tax Code stipulates that if the amount of controlled transactions is more than AMD200 million during a reporting period, the transaction(s) should be reported to the State Revenue Committee of Armenia (SRC).

### 2.2 Issue No. 2

Chapter 73 of the Armenian Tax Code, a dedicated chapter on TP regulations, provides only general framework and the "theory" of the TP regulations. It includes provisions neither on conduct of tax administration or procedures of TP audit, nor on taxpayer compliance. It is regrettable that the Armenian Tax Code has provisions on requiring taxpayers to submit notice on their controlled transactions and preparing TP documentation, but lacks provisions on how to check the documentation and how to conduct tax administration and tax audit. Moreover, the current TP regulations do not include provisions on fines and penalties for not submitting the notice on controlled transactions or documentations. In fact, many taxpayers do not submit the notice on controlled transactions and TP documentations as there is only a fine of AMD20,000 (approximately USD44) for not submitting the notice, and there is no fine or penalty for not submitting TP documentations. As a result, the lack of practical penalties makes it difficult for tax authorities to conduct tax administration or implement TP regulations when taxpayers fail to follow the rules.

With regards to the audit procedure of TP cases, the current regulations do not include a provision on how and where taxpayers can make tax calculation adjustments as the profit tax calculation reports do not contain a part envisaged for TP cases. Although there are no TP audit cases yet, this issue makes it difficult for taxpayers to make self-adjustment in their tax calculation reports.

### 2.3 Issue No. 3

Another regulation that is absent from the Armenian Tax Code is the three-tiered TP documentation system. Although the Tax Code contains an article on TP documentation and the required information, it does not contain provisions on the three-tiered TP documentation system, i.e., the master file, the local file, and the Country-by-Country Report (CbCR), one of the minimum standards of the OECD BEPS project. The reason why the three-tiered documentation system is missing in the Tax Code is that Armenia was not a member of the OECD BEPS Inclusive Framework (IF) when the TP regulations were developed in 2014-2015. In February 2019, Armenia participated in the OECD BEPS project, and was committed to amending its legislation to include the three-tiered documentation system. It is regrettable that these legislative changes, however, have not been adopted in the Tax Code.

Now Article 376 of the Tax Code includes the information a taxpayer needs to refer to in the transfer pricing documentation. The required information is as follows:

- Detailed description of the business functions of the taxpayer, including the analysis of the influence of economic factors on the processes of pricing of goods, intangible assets, works and/or services;

- Detailed description of the organisational structure of the taxpayer;
- Description of the controlled transactions, including the analysis of comparability factors prescribed by Article 365 of the Code, as well as the functions performed, assets used and risks assumed by the parties to the controlled transaction;
- Description of the applied transfer pricing methods and the rationale behind the choice of the particular pricing method in accordance with Article 368 of the Code;
- List of the parties to the controlled transactions, including information on the residence of the party for the purpose of taxation;
- Description of the sources of information on the comparable uncontrolled transactions;
- Calculation of the arm's length range (where applicable);
- Financial and other necessary information on the tested party;
- Detailed information on the adjustments made by the taxpayer independently in accordance with Article 374 of the Code; and
- Any other information which the taxpayer deems important for demonstrating the conformity of the conditions of performance of the controlled transactions with the provisions of Article 364 of the Code.

It can be said that the above-mentioned ten points are more or less similar to the information that is needed by the local file, according to the 2017 OECD TP Guidelines. But, being a member of the BEPS IF requires to adopt legislative changes and have provisions on implementing its Minimum Standards. Hence, the Armenian Tax Code needs to include provisions on BEPS Action Plan 13, namely, the master file, the local file and the CbCR.

### 2.4 Issue No. 4

According to Chapter 73 (Articles 360-378) of the Armenian Tax Code, in particular Part 1 of Article 363 ("controlled transactions"), the term "transaction" refers to supply of goods, alienation of intangible assets, performance of works and/or provision of services. In practice, the scope of this definition is so limited that taxpayers may wonder whether, for example, provision of borrowings between related companies, transfer of the right to use an intangible asset, alienation of financial assets, or concession right for money demand could be considered as a controlled transaction. This may result in difficulties when tax authorities carry out TP regulations.

### 2.5 Issue No. 5

This issue involves the term "taxpayer", i.e., those who are subject to the TP regulations. Article 362 ("Related Taxpayers") mentions the criteria by which two parties can be regarded as related for TP purposes and considered "taxpayer". According to Point 11, Part 1 of Article 4 ("Main Concepts Used in the Code") of the Tax Code, however, the term "taxpayer" refers to an organization or a natural person (including an individual entrepreneur, notary) who has or may have an obligation to pay a tax or make a payment in the cases prescribed by the Tax Code or laws of the Republic of Armenia on fees. The use of this definition in the TP regulations could be problematic. In international best practices, TP regulations mainly involve relationship between resident and non-resident taxpayers, but tax payment by non-resident taxpayers in Armenia is regulated by tax treaties. Therefore, a non-resident taxpayer may not have the obligation to pay taxes in Armenia, and thus may not be regarded as a taxpayer for the purposes of the Tax Code. As a result, it would be difficult to determine whether the two parties are related under the TP regulations.

## 3. Proposed Amendments and Additions to the Armenian TP Regulations

As discussed above, it is necessary that the Armenian TP regulations need to be amended to facilitate tax administration practices. A project was thus proposed on "Making Amendments and Additions to the Tax Code", which came into force on 13 April 2022. The project tackles the above-mentioned issues and presents

the following "solutions" to each of them:

**For Issue No. 1** Examining the international best practices on TP regulations, the project found that TP regulations in most countries cover profit tax (i.e., corporate income tax) and royalty payment for the extractives in some cases (including in Armenia). Very few countries, however, apply TP regulations to VAT. Given this, the Project removed VAT from the Armenian TP regulations. This change also solved possible issues that the taxpayer would have faced in case of keeping the VAT within the TP rules framework.

**For Issue No. 2** The Project separated the TP audits from other tax audits and designed the exclusive procedure of TP audits. To be more specific:

- Audit duration: 90 working days, with a possibility to be extended for another 90 working days;
- Statute of limitations: up to 5 years;
- Tax calculation report: a separate report from that of a general tax audit, which will be elaborated later and used only for the purposes of TP adjustments; and
- Risk criteria: to be developed as the basis for TP audits.

Also, a system of fines and penalties will be implemented. For taxpayers who fail to submit the notice on controlled transactions, the following fines will be imposed:

(1) AMD5 million (approximately USD11,000) — for companies having more than AMD2 billion (approximately USD4.4 million) turnover during the previous tax year;

(2) AMD2 million (approximately USD4,400) — for companies having more than AMD1 billion (approximately USD2.2 million) turnover during the previous tax year;

(3) AMD1 million (approximately USD2,200) — for companies having less than AMD1 billion (approximately USD2.2 million) turnover during the previous tax year; and

(4) For taxpayers who fail to file a controlled transaction in the notification form, a fine of AMD500,000 (approximately USD1,100) would be imposed.

For taxpayers who fail to submit TP documentation to the SRC within the set period (30 working days, according to Article 376 of the Tax Code), a fine of 10% of the value of the transaction would be imposed, and for late submission, a penalty of 0.04% of the value of the transaction for each day late.

**For Issue No. 3** The Project added a provision on the three-tiered TP documentation in accordance with the OECD TP Guidelines (2017) and BEPS Action Plan 13. An article on Advanced Pricing Arrangement (APA) was also added to the TP regulations, and will be put into effect on 1 January 2024.

**For Issue No. 4** The scope of the term "controlled transaction" was extended to cover the following activities: (1) provision (or receipt) of the right to use an intangible asset; (2) provision (or receipt) of borrowings; (3) provision (or receipt) of the concession rights for money demand; and (4) alienation of a financial asset. It is important to extend the scope of the term "controlled transaction", which will help promote tax compliance and prevent tax base erosion.

**For Issue No. 5** The term "taxpayer" was replaced by the term "person", a definition that covers a natural person, a legal person, a trust or any type of legal entity, which does have a status of legal person, according to the legislation of the contracting states of tax treaties.

## 4. Conclusion

The current TP legislation of Armenia was elaborated back in 2014-2015. Since then, the international standards of TP regulations have been updated by the BEPS project. As a result, it is necessary that the Armenian TP legislation be amended accordingly. Another important reason was that Chapter 73 of the Tax Code did not contain provisions on the procedure of conducting TP audits and ensuring tax compliance.

Thus, a project to amend the Armenian TP regulations was launched to tackle the five biggest issues in an effort to make the TP regulations more effective and further enhance tax compliance.

# Implementation of the Electronic Cash Register in Sierra Leone — How Far has the National Revenue Authority Come?

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***Abstract***: Sierra Leone National Revenue Authority (NRA) has struggled with a manual system of tax administration for so many years. The Domestic Tax Department that deals with Goods and Services Tax (GST) was also overwhelmed by a manual receipting system, which obviously posed serious threat to revenue growth and the overall tax administration system. Prior to the digitalization of the processes and procedures of the tax system, the NRA's key focus was directed towards increasing compliance and revenue using other techniques in the absence of automation. The introduction of the Electronic Cash Register is proving to be a game changer in the domestic revenue mobilization. This article gives us an insight into how far the NRA has come in the implementation of the Electronic Cash Register.

***Keywords***: GST; Tax administration; Digital revolution; Tax compliance

## 1. Introduction

Despite the growing need to international financial aid by developing countries around the world especially in times of economic crisis, many countries including Sierra Leone have considered domestic resource mobilization as one of their major priorities. To this end, the National Revenue Authority (NRA) has in recent times dedicated most of its efforts towards the utilization of some of the most recent technologies in the field of taxation around the world. The implementation of digital reforms and its related policies has been rife within the NRA.

Although several reforms have been implemented by the authority including the major ones highlighted in this piece, the Electronic Cash Register (ECR) will be the focus of this article.

## 2. Implementation of the Electronic Cash Register

In the last three years, the NRA has witnessed massive digital revolution in different areas of operations. Parts of the NRA's activities are mainly involved with building an effective system that propagates transparency and enhancing tax administration which can be squarely achieved through digitalization. To facilitate the consistency and efficiency of the data collection system, the NRA has implemented the ECR System which is among the three major reforms implemented by the authority in the last three years. The ECR is an electronic device designed to track the sales of business transactions by businesses mainly registered for Goods and Services Tax (GST). The system comprises the Sales Data Controller (SDC) and the Certified Invoicing System (CIS) used for signing receipts and sending this information to the NRA server. The Electronic Cash Register device is installed by the authority as part of its mandates under Section 25 Subsection 1, 2 and 3 of the Finance Act 2018.

In his New Direction manifesto in 2018, President of the Republic of Sierra Leone Julius Maada Bio had made commitments to promote transparency in the country's tax system.

## 3. Challenges with the Manual GST Regime

It is evident that the manual receipting system poses serious threat to revenue growth and the overall tax administration system. Prior to the implementation of the ECR, the NRA's key focus was directed towards increasing compliance and revenue through other techniques in the absence of automation. Among other reforms implemented by the authority, the ECR seems to have had the most impact on increasing revenue.

Not only were the operations of the NRA stuck along the way as a result of the manual invoicing system and verification, the efficiency of reconciliation was also greatly affected. Verification of input GST which forms part of the activities of the NRA requires taxpayers to claim Input GST payment made during relevant transaction upon the clearance of goods. However, the manual system poses serious challenge to the verification of these claims in most instances because of delay in filing of returns caused by overlaps in time. Furthermore, time relapse in filing tax returns by taxpayers had mostly left the authority with no choice but to levy penalties on defiant taxpayers, which have mostly been spurred from both financial and time wastages.

According to the NRA Commissioner General Samuel S. Jibao's statements as published in the Sierra Leone Telegraph in October 2020, businesses have been using manual GST Tax Receipt to undervalue tax returns, while a receipt is generated that will enable the NRA to know exactly what the business should pay in every transaction done with the ECR.

To make the monitoring and reconciliation of sale transactions easier, the NRA with support from the government of Sierra Leone and the Ministry of Finance made 5,000 electronic machines available to be installed at all GST registered business premises across the country. This was aimed at minimizing penalties, thereby promoting voluntary compliance. This action was however complemented by hosting several engagements and weekly trainings specially designed for taxpayers to ensure ease in the use of the ECR.

## 4. Complementing Systems to the ECR System

Two significant complementing systems to the ECR are the Integrated Tax Administration System (ITAS) and the Automated System for Customs Data (ASYCUDA WORLD). Therefore, the ECR is far from operating alone. The former allows for the filing of GST returns while the ECR interfaces with the latter to verify claims for input GST collected at Customs.

One of the major achievements made by the authority over the years is a substantial increase in tax effort from 12.3% in 2017 to 15.6% in 2021, which accounts for a 3% increment in less than four years. This however accounted for the full implementation of only one major reform, among several reforms which are presently imple-

mented by the authority. Following the increase in revenue generation, it is obvious that the full implementation of not only the ECR, but also all major reforms will have a substantial increase in revenue growth and compliance. However, it is important to note that the implementation of the ECR will boost revenue in several ways.

## 5. Misconceptions on the Implementation of the ECR and Current Development

Following up on controversies and perceptions held by the public about the motives behind the installation and use of the ECR machine, Samuel S. Jibao said in one of his statements during a press conference held on 22 January 2022 that "Contrary to what people seemingly believe, the Electronic Cash Register is not an added tax but rather a means of simplifying business transactions, it is a mere calculator which records sales as opposed to the complex device the masses think it is".

- That the burden of GST lies on business owners is not the case.
- The Commissioner General's visit to business premises was to close businesses, but the visit was actually geared towards verification and installation.
- The input GST was misunderstood as double taxation.
- The machine is targeting micro businesses — there is a different regime for micro businesses.
- That GST is on all commodities is not the case — GST is not charged on rice, flour, baby food, certain pharmaceuticals, etc.
- There is a 15% automatic increase on all goods and services, if receipts are issued on the machine.

One major misconception is that the hike in prices was caused by high taxation. The Commissioner General outlined some measures taken by the Government to keep prices within the range of the ordinary individuals. The removal of import duty on rice, flour, and oil, the reduction of taxes on essential commodities like cement from 20% to 10%, iron rod from 10% to 5% and cooking gas from 5% to 0% have thus resulted in the loss of billions of Leones in national revenue every year, according to Samuel S. Jibao.

There are several challenges in the implementation and installation of the ECR, ranging from the reluctance in the submission of accurate taxpayer information, low acceptability level, to rejection in the acceptance of the cash machine amongst others.

However, just about recently, the Commissioner General's verification tour accounted for a huge turnout in the acquisition and installation of the cash machine at business premises. As of February 2022, over 2,800 machines were installed at business premises across the country, which accounted for over 50% of the total machines that were previously commissioned.

No doubt that Sierra Leone is one of the developing countries in the world that is ready to change the digitally divided society to an inclusive informed society capable of breeding economic independence. In the phase of all the challenges, the fact cannot be dismissed that both taxpayers and tax authorities tend to enjoy the convenience and comfort of a simplified tax regime free from delay, manual errors and data disruption.

# Moving from Vision to Action: Case of Shenzhen Tax Service

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***Abstract***: Local tax services of the State Taxation Administration of China (STA), as direct service providers to taxpayers and fee-payers, can contribute to the cooperation of China with other Belt and Road Initiative (BRI) jurisdictions under the framework of the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM). Guided by the STA, Shenzhen Tax Service (STS) is actively engaging in the development of the BRITACOM in an effort to achieve its vision, i.e., building a growth-friendly tax environment. The STS aims to establish a win-win cooperation mechanism that could serve as a model among other local services. This article focuses on three major issues, i.e., the significance, the actions and achievements as well as the future prospects of the STS to facilitate the long-term growth of the BRITACOM.

***Keywords***: Local tax service; BRI; BRITACOM; BRITACEG

## 1. Introduction

According to the World Bank Group (WBG), the annual global growth forecast for 2022 has been lowered down from 4.1% to 3.2%, citing the impact from the recent geopolitical conflict.[1] David Malpass, the WBG President, said that the largest single factor in the reduced growth forecast was a projected economic contraction of 4.1% across Europe and Central Asia.[2] Higher food and fuel costs being borne by consumers in developed economies across the world could be the other factor behind the slowdown in growth from the forecast.

Undoubtedly, turbulence in the global economy and revamping of international tax rules will aggravate tax uncertainties and cross-border disputes. Meanwhile, the changing business models and tax compliance issues brought by digital economy also challenge the sustainability of conventional industries. In addition, as jurisdictions are struggling with the financial impact of the lingering COVID-19 pandemic, there is an urgent need for capacity building and digitalization of tax administration. Therefore, it is of practical

1 https://www.reuters.com/business/world-bank-says-war-cut-global-growth-boosts-financing-target-2022-04-18/.

2 Ibid.

value to strengthen tax coordination and collaboration among the Belt and Road Initiative (BRI) jurisdictions so as to help business cope with such challenges.

With the joint contribution of all parties, the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM) was established in April 2019, and has scored some achievements during the past three years. In this context, Shenzhen Tax Service (STS),[3] a local tax service[4] of the State Taxation Administration of China (STA), is an active contributor to the BRITACOM. This paper elaborates on the significance of local participation, and examines the actions and achievements, as well as the future prospects of the STS to facilitate the development of the BRITACOM.

## 2. Local Tax Services and the BRITACOM

Acting under the framework of the BRITACOM, local tax services will facilitate the implementation of the plans of the BRITACOM, and, in turn, benefit themselves from this process.

### 2.1 From the BRITACOM Perspective

#### 2.1.1 Underpinning the operation of the BRITACOM

The BRITACOM has created a platform for multilateral tax dialogues, where local tax services can provide resources, such as manpower and other logistics support in hosting the Belt and Road Initiative Tax Administration Cooperation Forum (BRITACOF), working with task forces of the relevant Action Plan in conducting researches and drafting reports, as well as providing trainers for the BRI Tax Academies (BRITA) under the framework of the Belt and Road Initiative Tax Administration Capacity Enhancement Group (BRITACEG).

#### 2.1.2 Leveraging achievements of the BRITACOM

It is necessary for tax administrations of BRI jurisdictions to put the achievements of the BRITACOM into practice, examine the solutions and give timely feedbacks, so that practical experiences could be collected and shared to help translating the achievements of the BRITACOM into productivity.

#### 2.1.3 Enhancing the collaboration among BRITACOM participants

As the BRITACOM has been translated from a blueprint into working plans, the active contribution of local tax services will help improve this mechanism. Differences of local tax administrations usually reflect the distinctions of the tax environment in various jurisdictions. This allows the BRITACOM to collect experience and enhance the collaboration of its participants on the basis of "seeking common ground while reserving differences".

#### 2.1.4 Expanding the influence of the BRITACOM

Only with extensive participation of tax administrations at various levels, will the BRITACOM become a platform of substantial influence for international tax dialogues. Local tax services will improve the overall level of taxpayer service for the BRI and enhance the influence of the BRITACOM by making use of their distinctive advantages. For instance, Shenzhen could give full rein to its role as the core city of the Greater Bay Area (GBA)[5] with its technical expertise and talent teams.

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3 Shenzhen is located on the southern tip of the Chinese mainland and on the eastern bank of the Pearl River, adjoining the Hong Kong SAR. Since China's first special economic zone was established here in 1980, Shenzhen has been a touchstone for China's reform and opening-up policy.

4 Tax administrations in China constitute the STA (the headquarters), and tax services top-down at provincial, municipal, and district or county levels. The local administrations in this article refer to all the other tax administrations in China except for STA headquarters.

5 It includes the Hong Kong SAR, Macao SAR and 9 cities in Guangdong Province such as Guangzhou, Shenzhen, Zhuhai, Foshan, Huizhou, Dongguan, Zhongshan, Jiangmen and Zhaoqing, with a total area of 56,000 square kilometers. It is one of the most open and economically dynamic areas in China.

## 2.2 From the Perspective of Local Tax Services

### 2.2.1 Expediting resolution of cross-border tax disputes

Statistics show that, by the end of 2021, Shenzhen-based enterprises had registered 8,169 subsidiaries or branches in 146 jurisdictions. More than 160 jurisdictions have established foreign-funded enterprises in Shenzhen, and the foreign direct investment projects in Shenzhen have reached more than 100,000.[6] Since Shenzhen is an export-oriented city, the STS has made a lot of efforts in promoting the exchange and cooperation with tax administrations of other BRITACOM jurisdictions, so as to improve the effectiveness and efficiency of cross-border tax dispute resolution and better protect the legitimate rights of going-global and bringing-in enterprises.[7]

### 2.2.2 Enhacing the capacticity of tax administration

The improvement of tax administration capacity lies in learning advanced ideas and good practices from others. The BRITACOM offers a platform for capacity building. Routine offline and online meetings, high-quality seminars and professional training programs help local tax services broaden their vision and improve their capacities. For example, the STS has enhanced its own capacity by translating tax reports of the BRITACOM.

### 2.2.3 Encouraging researches on international taxation

The BRITACOM is a platform where local tax services can address challenges arising from the globalized economy by strengthening cooperation and dialogue with other tax administrations. For example, the STS has contributed to the BRITACOM by publishing articles in the *Belt and Road Initiative Tax Journal* (*BRITJ*).

## 3. Practices of STS in Contributing to the BRITACOM

Under the framework of the BRITACOM, the STS is "systematic, optimized and integrated" in its operation, and helps build the BRI

6 http://www.chinadevelopment.com.cn/news/cj/2022/02/1764520.shtml

7 The strategy of going global and bringing in is a major effort by the CPC Central Committee and the State Council of China to meet the needs of economic globalization and China's economic development. Going global is a key strategy to develop the open economy and comprehensively improve China's opening up to the outside world. The bringing-in strategy aims to introduce advanced technical talents and leading managerial expertise from abroad, and selectively attract foreign investments into Chinese market without undermining domestic economic environment.

and the BRITACOM by optimizing the institutional structure, improving the collaboration mechanism and pressing ahead with self-reform.

### 3.1 Building an Institutional Structure for Better Operation

The STS has created the 1+2+N BRI Tax Service System (hereinafter referred to as "the 1+2+N System"), which aims to bring taxpayer service under the framework of the BRITACOM into the practice of local tax services by linking this mechanism with local taxpayers.

To be more specific, "1" refers to the STS, the leading body in Shenzhen to pursue the BRITACOM vision.

"2" refers to the two sides of the STS business, i.e., domestic and overseas. With the BRITACOM in place, the STS is better positioned to offer quality and efficient tax services to going-global and bringing-in enterprises. In terms of domestic tax service, the STS tailors its services for bringing-in enterprises, and hence

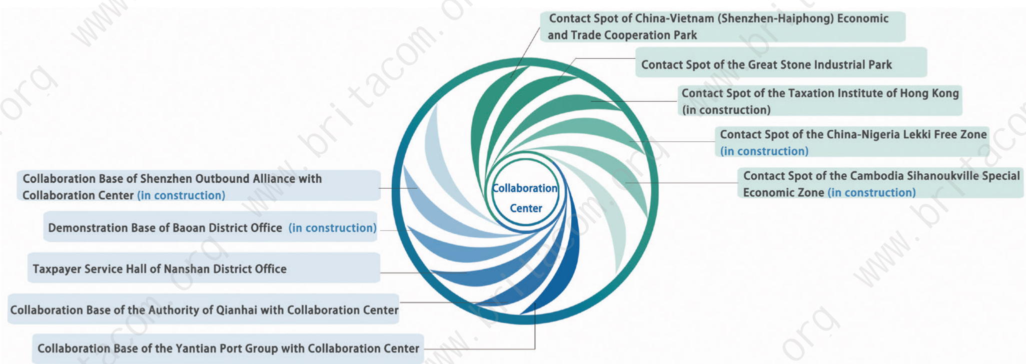


Figure 1. 1+2+N BRI Tax Service System

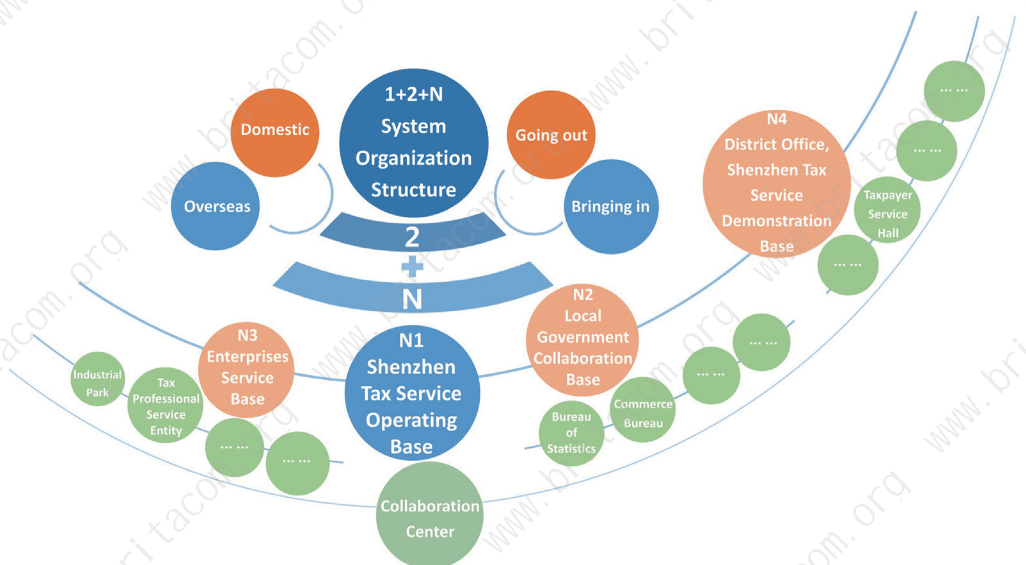


Figure 2. Institutional Structure of the 1+2+N System

improves tax compliance and social satisfaction with various measures. As for overseas service, the STS builds an overseas BRI tax service platform through tax officials dispatched to work in foreign jurisdictions, the BRI collaboration base and overseas points of contact, so as to help going-global enterprises enhance their international competitiveness.

"N" refers to the existing four-tiered institutional system of the BRI tax service, which encompasses the operation base at the STS headquarters, the collaboration bases at local governments, the service bases at enterprises and the demonstration bases at sub-offices. Specifically, the operation base at the STS headquarters, also known as the Collaboration Center, makes the overall planning of the aforementioned bases in different tiers. The collaboration bases at the local governments, established under the joint efforts of the Collaboration Center and the designated local government agencies, break the administrative barriers among them and ensure that they work closely. The service bases at enterprises established by the Collaboration Center provide direct services for domestic and overseas enterprises. The array of demonstration bases at the sub-STS offices carry out the pilot projects of the BRITACOM, provide personnel, venue and other resource support for the BRITACOM, and formulate unified standards for taxpayer service in BRI jurisdictions.

## 3.2 Contributing to the Improvement of Taxpayer Service in BRI Jurisdictions

The STS is well positioned to facilitate the comprehensive development of taxpayer service in BRI jurisdictions under the framework of the BRITACOM.

### 3.2.1 Providing manpower support

The STS attaches great importance to the cultivation of international tax officials. In recent years, the STS has speeded up the recruitment and training of talents with good foreign language skills, establishing a talent team of more than 220 people with a good command of both foreign languages and international tax rules. Their working languages cover all the official languages of the United Nations. At the 1st BRITACOF in April 2019 hosted by the STA, the STS sent a team of 17 tax talents who can speak six foreign languages to support the logistics and liaison of the conference.

In addition, the STS focuses on fostering trainers for the BRITACEG. Three tax officials of the STS have been selected as trainers of the BRITACEG. The STS also encourages tax officials to further participate in the BRITACOM task forces and seminars. In this way, the STS builds its team with expertise in taxation, foreign languages and teaching methods.

### 3.2.2 Offering optimal venues

Thanks to the geographical features and preferential policies of Shenzhen, the STS offers a wide range of venues for on-site visits and training programs as well as academic seminars, thus expanding its "circle of friends". In its demonstration bases for BRI tax service, the STS has successively received visits of seven groups with a total of 101 international experts, tax officials and representatives of multinational enterprises from 30 jurisdictions in recent years. To further enrich the content and form for demonstration and upgrade taxpayer service, the STS has set up two Demonstration Bases at district-level offices, where world-class digitalized taxpayer service halls with systematic administration and service in international tax are equipped.

Apart from making more friends, the STS has become a good disseminator as well. With the arrangement of the STA, through its officials dispatched to work at international organizations and Chinese embassies in foreign jurisdictions, the STS showcases the progress and achievements as well as its experience in taxpayer service and tax administration. It also shares the local experience of how to solve tax disputes among BRI jurisdictions. At present, overseas STS officials, with a good command of English, French, Arabic and Russian, are working at the headquarters of the International Bureau of Fiscal Documentation (IBFD) in Amsterdam, and some Chinese embassies in different continents. They are committed to building a fair and modern international tax system for China.

**3.2.3 Showcasing technical advancement**

The 2nd BRITACOF took the theme of "Digitalization of Tax Administration", during which tax administrations of many jurisdictions shared experience on tax administration digitalization, tax service digitalization, new technologies in taxation and so on. The STS follows the STA blueprint on digitalization closely and contributes its fair share as a forerunner in Smart Taxation. It is one of the earliest to adopt smart technologies like blockchain invoice and non-contact taxpayer service. It keeps upgrading the smart administration for cross-border transactions so as to improve its digitalized tax administration for international tax issues. For one thing, at the STS, "one network for all tax matters of cross-border transactions" is built for the maximum benefit and convenience of taxpayers, and taxation integration in the Pearl River Delta[8] is hence initiated. For the other, it has built a digital management platform for international taxation. The STS has improved its online service for cross-border filing and payment, and automated tax administration and collection on the basis of data integration and intelligent regulation on non-resident enterprises.

## 3.3 Enhancing Capacity at the Local Level

**3.3.1 Broadening the global vision of local tax officials**

The BRITACOM offers a new gateway for local tax administrations to engage in international affairs. In the context of global pandemic, the STS who focuses on the BRI tax service keeps enhancing its international presence.

By participating in online and offline events, such as international conferences and tax seminars, the STS benefits a lot in terms of organizing international training programs and conferences, and grows together with its foreign counterparts via exchanging views on hot tax issues and sharing tax administration experience.

The STS builds its own top expert panel on international taxation by teaming them up in task forces and in projects. These experts have grown to be competent participants in formulating international tax rules.

A talent team of local tax officials is also taking shape as the STS sends them to serve as trainers for the BRITACEG training programs. These officials constitute the talent echelon of the STS, enabling the STS to play a greater role in building a win-win tax environment.

**3.3.2 Improving taxpayer service**

As a platform for mutual learning and reference, the BRITACOM helps BRI jurisdictions to improve taxpayer service together. During the process, the STS has contributed valuable local experience.

**• Expediting Dispute Resolution**

Drawing on its practical experience, the STS has set up an efficient dispute resolution mechanism via three steps so as to reduce the compliance cost of enterprises, which is conducive to their future development.

Step 1: The STS takes the organization-wide approach in building the mechanism, so that all the sub-offices adopt the unified standards in taxpayer service and dispute resolution.

Step 2: The STS pursues consistency in advance ruling for dispute resolution in major cities of the GBA.

Step 3: The STS proactively cooperates with local tax administrations of other BRITACOM jurisdictions in settling tax disputes and proposes valuable suggestions to the STA headquarters and other competent authorities.

To this end, the STS has established a new model of taxpayer service in overseas industrial parks through the Collaboration Center. This model works to build a channel for going-global enterprises to better discuss tax issues

8 Pearl River Delta is short for the Pearl River Delta Economic Zone, which was proposed by the Guangdong Provincial Committee of the CPC on 8 October 1994. It is located in the south-central Guangdong Province of China, with a total area of 55,368.7 square kilometers, covering 9 cities comprising Guangzhou, Foshan, Zhaoqing, Shenzhen, Dongguan, Huizhou, Zhuhai, Zhongshan, and Jiangmen.

with overseas-based STS tax officials, operators of the parks and tax officials at both the local and central levels of BRI jurisdictions. In this connection, the STS analyzes the investment structure, business mode and scale of these enterprises, and establishes the points of contact by sending officials to work at overseas industrial parks invested by China. In recent years, the STS has facilitated dialogues among the China-Vietnam Cooperation Park, the Shenzhen enterprises investing in Vietnam, and the Vietnam-based STS officials on tax matters, and has assisted in settling the disputes on corporate income tax incentives between the China-Vietnam (Shenzhen-Haiphong) Economic and Trade Cooperation Park and the Vietnam Tax Administration. In addition, it reaches out and offers guidance for 60 industrial parks in Qianhai[9] and the National Free Trade Zone Innovation Alliance. This innovative model is a display of how the STS and its sub-offices offer unique solutions to help local enterprises cope with cross-border tax issues.

**• Streamlining Tax Compliance and Enhancing Tax Certainty**

At the 2nd BRITACOF, member tax administrations put forward multiple solutions to issues such as realizing tax certainty, expediting dispute resolution and streamlining tax compliance in the *Wuzhen Action Plan (2019-2021)*. The STS's work on tax certainty and streamlining compliance in the GBA has provided a good solution from China's perspective and may serve as a valuable reference for its peers in BRI jurisdictions.

In order to meet the specific needs of the enterprises in the GBA, the STS has strengthened regional coordination in tax enforcement and explored advance ruling on large businesses and international tax transactions. At present, the STS and Guangzhou Tax Service have performed Joint Advance Ruling Management of International Tax Matters on five types of international tax matters, such as cross-border equity transfer. Four cases involving different tax matters have been successfully closed, with a total of RMB2.5 billion in transaction and hundreds of millions of RMB in taxes. This brings tax certainty to taxpayers with similar needs.

In addition, the STS establishes the mechanism of Cooperative Management of Tax Treaty Treatment in the GBA in view of the reality that a non-resident taxpayer may have multiple withholding agents across this area and have to respond to multiple tax administrations when tax inspections are undertaken on the qualifications for treaty benefits. Under this mechanism, tax administrations in different cities share information, perform joint verification process, apply unified enforcement standard, and recognize decisions made by their counterparts. Also, special personnel will be assigned to communicate with enterprises, collect information and requirements from enterprises, further optimize counseling services, respond to tax-related appeals of enterprises, and respond to questions about tax policy. This helps improve tax certainty, reduce the compliance burden and enhance taxpayers' satisfaction. Among them, Chow Tai Fook (Shenzhen) Jewelry Co., Ltd., a renowned jewelry group, is the first overseas enterprise to benefit from this mechanism. Chow Tai Fook has set up 153 companies in the GBA, qualified for treaty benefits totalling RMB492 million in corporate income tax. Furthermore, the STS continuously improves the accuracy of law enforcement through training, online information delivery and door-to-door consultation, so as to help foreign enterprises properly apply tax policies and stabilize their investment in China.

9 The Authority of Qianhai is a dispatched agency established by Shenzhen Municipal Government in February 2010. It is a statutory board implementing an enterprise-style management, but not for profit-making purposes, and fulfilling the corresponding administrative and public service functions. It shall be responsible for carrying out functions and duties conferred by laws and regulations, and promoting the development of the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone.

## 4. Future Prospects

### 4.1 Giving Full Play to Local Advantages

The BRI is an initiative of win-win cooperation for common development and prosperity for all relevant parties. Guided by the STA headquarters and pursuing the vision of the BRITACOM, the STS will leverage its geographical advantages and proactively take the initiative to realize the goal of the BRITACOM. The 1+2+N System will be adopted in Shenzhen across the board, promoting the convergence of rules and mechanisms on tax administration and taxpayer service, and enhancing the efficiency of tax dispute resolution across the GBA. Driven by the "N" bases located in Shenzhen (especially in the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone,[10] Shenzhen-Hong Kong Innovation and Technology Co-operation Zone[11] and Yantian Port), the Collaboration Center will continue to develop and expand the coverage of such "N" bases in the GBA.

### 4.2 Implementing the Nur-Sultan Action Plan (2022-2024)

The STS will keep improving tax dispute prevention mechanism, such as advance ruling and APA, by expanding the scope of application for advance ruling and facilitating the coordination and consistency of taxpayer service among the nine cities in the GBA. Besides, the STS will support the STA in strengthening digitalized tax administration by launching training programs in the BRITACEG, deepening the application and sharing of big data, and building a data governance mechanism suitable for BRI jurisdictions. Furthermore, it will optimize the tax environment by establishing archives of going-global and bringing-in enterprises, sorting out tax rules and regulations in BRI jurisdictions, and standardizing the offline and online tax policy interpretation and publicity.

Moreover, the STS will support the STA to build capacity by encouraging more tax officials to conduct BRITACOM researches and take part in BRITACEG training programs, so as to broaden the horizon of STS tax officials and attract more talents to join the STS. It will also build regular communication mechanisms at local tax service level, such as strategic cooperation with other tax-related government agencies including the Customs, the Bureau of Commerce, and the Bureau of Statistics, etc. It will also strengthen communication by building these good practices into a cultural brand. The STS plans to publish quality international tax reports, produce a series of training materials for the "N3" bases overseas, and continue to develop more BRI demonstration bases and taxpayer service halls.

### 4.3 Responding to Challenges Arising from Digital Economy and Changes of International Tax Rules

Against the background of the rapid development of the digital economy, local tax services should improve their ability to respond to new international tax rules. Recently, the Two-Pillar solution has attracted wide attention in international society. The main goal of this

10 The total area is 120.56 square kilometers. The development and construction of the Qianhai Cooperation Zone is an important measure to support the economic and social development of the Hong Kong SAR, deepen the cooperation among Guangdong Province, the Hong Kong SAR and Macao SAR, and build a new pattern of opening up. It aims to serve as a pilot zone for Shenzhen-Hong Kong cooperation, a zone for system and mechanism innovation, and a zone for the gathering and structural adjustment of modern service industries.

11 Located in the southern part of Futian District, Shenzhen, and bordering the Hong Kong SAR, the Zone consists of the Hong Kong Park (approximately 0.87 square kilometers) and Shenzhen Park (approximately 3.02 square kilometers). It aims to build a world-class scientific research center and promote the innovation and development in the GBA.

solution is to deal with the allocation of taxing rights through Pillar 1 and the erosion of tax base through Pillar 2. The Two-Pillar solution is, in essence, seeking an in-depth co-governance in taxation through the legal instrument of multilateral tax conventions.

To this end, the STS, under the instructions of the STA headquarters, will actively participate in the assessment of the Two-Pillar solution and analyze its potential implications on enterprises, the economy and tax revenues of Shenzhen. At the same time, the STS will further conduct researches on the impact of hot issues in international taxation such as the Two-Pillar solution and the carbon border adjustment mechanism via the 1+2+N System. The STS will also continue to assist the STA headquarters in strengthening capacity building, which may be of some references for BRI jurisdictions to better respond to the challenges posed by the ever changing international tax landscape.

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# 2021

## 23 December 2021

### Virtual Meeting Between Algerian Tax Administration and the BRITACOM Secretariat

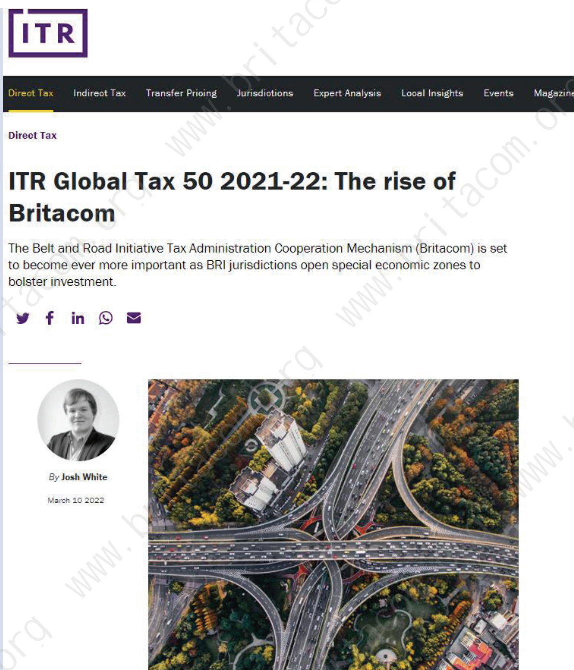
A virtual meeting between General Directorate of Taxes of Algeria and the BRITACOM Secretariat was held on 23 December 2021 to discuss the 3rd BRITACOF. With the confirmation of both sides, the 3rd BRITACOF with the theme of Enhancing Tax Administration Capacity Building in the Post-Pandemic Era is to be held on 19-21 September 2022. General Directorate of Taxes of Algeria will host the 3rd BRITACOF in a hybrid way both in Algiers, Algeria and online.

# 2022

## March 2022

### BRITACOM Listed in the ITR Global Tax 50 2021-22

In March 2022, BRITACOM was listed in *International Tax Review* (*ITR*) Global Tax 50 2021-22. The Global Tax list is an annual event since 2011, highlighting the most influential individuals, organizations, and geopolitical events in the tax world. The article of the *ITR* titled *The rise of the Britacom* points out that there is still intense competition in global trade, and BRITACOM has a crucial role to play in forging greater tax cooperation among BRI jurisdictions. This is a great honor for the whole BRITACOM family, showing that the concerted efforts made by the entire BRITACOM community began to pay off in its great cause to contribute to the establishment of a growth-friendly tax environment.




## 31 March 2022

### Virtual Seminar on Advance Tax Ruling of Large Businesses

The Virtual Seminar on Advance Tax Ruling of Large Businesses was held on 31 March 2022. Representatives from the BRITACOM Council Member Tax Administrations, Observers, the Advisory Board, and businesses attended the meeting. Speakers introduced their practices in implementing advance tax ruling and raising tax certainty, and also shared their views on the further improvement of advance tax ruling of large businesses. All participants and speakers contributed to this informative and engaging event.

## 18 April 2022

### Third Anniversary of the BRITACOM

18 April 2022 marks the Third Anniversary of the BRITACOM. With the firm support and contribution of all relevant parties, the BRITACOM has progressed smoothly over the past three years and has gained fruitful achievements. The Secretariat set up a special celebration banner on the BRITACOM website homepage (www.britacom.org) for people to review the milestones of the BRITACOM and send their best wishes. The pivotal role of all parties in strengthening cooperation and communication, and deepening sharing and understanding for a brighter future of BRITACOM has all contributed to the vision of building a growth-friendly tax environment.

## 27 April - 8 May 2022

### Courses on Tax Dispute Resolution

From 27 April to 8 May 2022, the BRITACOM has hosted a training program featuring tax dispute resolution in the form of live course plus video course with experts introducing theories and sharing experiences. To keep the courses interactive, 37 tax officials from five jurisdictions attended this program with in-depth introduction from the lecturers and exchanges from the participants. Participants speak highly of the curriculum design, course quality and the faculty, which has definitely enhanced their capacities in resolving tax disputes.

## April 2022

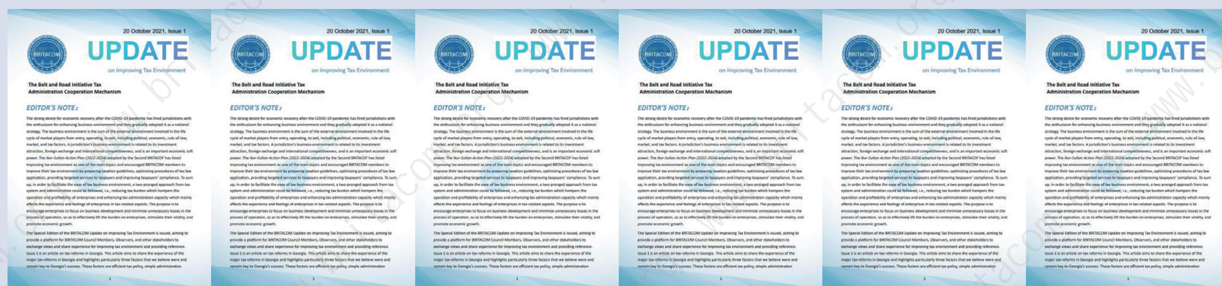
### Four Elementary-Level Courses

Since October 2021, the BRITACEG has taken phased steps to launch four elementary online courses on the Belt and Road Initiative Tax Academy website (https://www.brita.top/#/), covering dispute resolution, digitalization of tax administration, VAT reform, and taxpayer service, which were open until 15 April 2022. Over 400 tax officials from more than 20 jurisdictions have attended these courses. Trainees surveyed generally provided positive feedback, expressing their senses of benefit in terms of work and study, and their willingness to apply the knowledge and skills acquired to their practices in the future.

## April 2022

### Special Edition on Improving Tax Environment

Given the significance of tax environment on investment attraction, foreign exchange and international competitiveness, the *Nur-Sultan Action Plan (2022-2024)* adopted by the 2nd BRITACOF has listed improving tax environment as one of the main topics and encouraged BRITACOM parties to improve their tax environment by preparing taxation guidelines, optimizing procedures of tax law application, providing targeted services to taxpayers and improving taxpayers' compliance. The Special Edition of the BRITACOM Update on Improving Tax Environment is issued on the BRITACOM website (https://www.britacom.org/gkzljxz/Update_on_Improving_Tax_Environment/) since October 2021, aiming to provide a platform for BRITACOM parties to exchange views and share experience for improving tax environment. So far, special editions for Georgia, China, Malaysia, Hong Kong SAR of China, Singapore, and UK have been released.



## 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,

Editor-in-Chief
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