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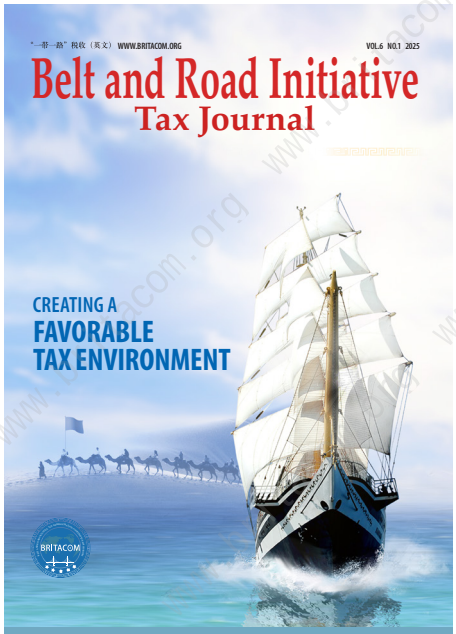

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In Brief

Leveraging Fully Digitalized Electronic Invoices to Establish a Model for Driving Digital China

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Abstract: China is building a model project of digital government with the fully digitalized electronic invoices (FDEIs) at the core. Through the "unified national e-invoice service platform", online invoice collection, automatic quota allocation and direct connection with enterprises can be achieved, which can reduce cost, enhance efficiency and promote digital transformation of enterprises. Relying on the precise supervision system of "data + rules", which covers hundreds of millions of trusted identity subjects, the platform can prevent and control risks in real time and align with international standards. The reform has achieved remarkable results: it has covered 95% of enterprises across the country, saved over RMB100 billion in costs annually, and reduced 30 billion paper invoices. Breakthrough innovations, including reconstructing the traditional invoice ecosystem, building the largest information technology innovation cloud platform and digital identity system, and promoting the internationalization of independent tax algorithms, have provided the Chinese solution for "data-driven tax governance" to the world, and contributed to high-quality development and high-level opening up.

Keywords: Fully digitalized electronic invoices (FDEIs); Tax administration digitalization; Smart taxation; Tax governance; Digital China

In the realm of goods and services, transactions are validated through currency, with invoices serving as the primary proof of these transactions. While invoices fall under the purview of tax authorities, their application transcends mere taxation, extending into finance, commerce, legal affairs, and beyond, making them an indispensable foundational document. Against the backdrop of the wide popularity of e-payment methods such as the WeChat Pay and ongoing trials of digital currencies, accelerating the implementation of the e-invoicing reform, and promoting the universal application of fully digitalized electronic invoices (FDEIs) is

crucial for advancing the drive of Digital China.

1. Reform Measures

Since 2021, the State Taxation Administration of China (STA) has established a unified national e-invoice service platform, and promoted the adoption of FDEIs across the country. This initiative has significantly reduced institutional transaction costs and facilitated the digital transformation of the economy and society.

1.1 Enhancing Digital Tax Services

We are innovating new service scenarios and accelerating the digital upgrade of tax payment processes. By using e-invoicing as a starting point, we employ digital technologies to comprehensively improve tax payment methods, vigorously promote high-quality and efficient intelligent tax services, and substantially enhance the experiences of taxpayers.

Firstly, achieving "online invoice collection" for more convenient invoice services. We have established an e-invoice service platform that provides 24/7 free online services for taxpayers, including issuing, delivering, and verifying invoices, thereby achieving full electronic processing of all aspects and elements of invoices. The process of taxpayers applying for invoices has evolved from the cumbersome "manual form filling and human approval" to the streamlined version of "contactless and online handling", realizing the long-awaited goal of "issuing invoices immediately after business commencement". This greatly enhances the digitalization and convenience of tax payments.

Secondly, implementing "automatic quota allocation" to eliminate the need for invoice approval. Tax authorities have activated digital tax accounts for taxpayers, automatically aggregating taxpayer information (including credit information). Based on this credit information, the system automatically assigns the total allowable invoice issuance quota. This not only exempts taxpayers from the hassle of applying for invoice issuance approvals but also effectively mitigates integrity risks in the realm of invoices.

Thirdly, pioneering "Natural System" services to accelerate enterprise digital transformation. By advancing "Natural System", we enable direct connections between tax authority and enterprise information systems, opening up technical specifications and operational guidelines for FDEIs issuance and usage to taxpayers. This offers automated and standardized information system connection services. Not only does it realize the goals of "issuing invoices upon payment" and "issuing invoices based on orders", it also supports functions like invoice deduction confirmation and verification for accounting purposes, thus promoting enterprises' acceleration towards digital transformation and upgrading.

1.2 Elevating Tax Supervision

We are establishing new management mechanisms to elevate the precision of tax supervision. By leveraging digital technologies, we aim to construct a novel tax supervision framework that shifts the paradigm from "managing taxes through invoices" to "governing taxes through data", ensuring the strictest standards are applied to prevent tax evasion while minimizing disruptions to normal business operations.

Firstly, implementing precise supervision with a "taxpayer-specific" approach. We have launched a credible identity system for the national tax network, providing unique online credible identities for all entities involved in taxes, fees, and invoices, encompassing hundreds of millions of business entities and individuals. Leveraging big data, we have established risk models to monitor every aspect of invoice issuance, delivery, and deduction. This ensures comprehensive oversight throughout the entire process.

Secondly, improving an "integrated" risk control chain. We continuously advance the construction of an "integrated" risk control mechanism, focusing on all stages of FDEIs management and linking related entities. Real-time monitoring scans for potential risks before, during, and after invoice issuance. Through data penetration into commodity flows, we employ a "product-centric" approach to supervise key commodities such as medicines, mobile phones, and motor vehicles, enhancing the tax supervi-

sion capabilities over these critical items. Risk levels dictate differentiated measures, ranging from reminders and alerts to service interruptions, tailored to the severity of the identified risks.

Thirdly, aligning with international standards. We have formulated and promoted the adoption of two national standards for e-invoices, marking the first national standards in the tax domain. Efforts are also being made to achieve interoperability with international norms and technical standards like the EU's Pan-European Public Procurement On-line (PEPPOL), facilitating cross-border data exchange, standard conversion, and secure control of FDEIs.

2. Reform Achievements

Currently, FDEIs have ushered in a new era for commercial transaction vouchers in China. They now cover over 95% of invoice-using enterprises nationwide, marking another momentous catalyst for the digital transformation of the economy and society following the e-payment revolution. This transformation has brought about numerous changes, even fundamental shifts, in areas such as market transactions, economic exchanges, tax services, government supervision, and international interactions. The widespread adoption of FDEIs has achieved a win-win outcome for multiple stakeholders, including taxpayers and tax authorities, the broader economy and society, national governance, and international cooperation.

2.1 Revolutionizing Invoice Processes

By realizing full digitalization across all stages of invoice processing, annual institutional transaction costs have been reduced by over RMB100 billion. FDEIs can be issued, delivered and stored digitally at zero marginal cost, materially lowering business operating expenses. For instance, after JD.com adopted FDEIs in 2023, it transitioned from issuing 80,000 batches or 320,000 paper invoices (80,000×4) daily to complete digital issuance and delivery, thereby reducing staffing needs at its billing center by more than 550 employees and saving the company RMB380 million annually. Expanding the application breadth and depth of FDEIs in commerce, finance, taxation, and legal affairs reduces the use of approximately 30 billion paper invoices per year and spares the felling of around 12 million trees annually, saving enterprises over RMB100 billion in invoicing costs each year. This contributes to the cause of both Digital China and Beautiful China.

2.2 Innovating Direct Connectivity

We have innovated the application model of government services through direct connectivity between tax authorities and enterprises to foster the digital transformation and upgrading of businesses. We have pioneered the "Natural System" model, which enables direct connections between enterprises' information systems and tax authorities' systems, accelerating the digital transformation of corporate finance and operations. By February 2025, over 4,200 large conglomerates and their 160,000 constituent entities had established direct connections with the tax authorities' information systems, issuing a total of 8.6 billion FDEIs. During the COVID-19 pandemic, FDEIs played a pivotal role in facilitating the resumption of work and production in regions like Shanghai, making the Shanghai International Port Group the world's largest container port for 13 consecutive years. In 2023, FDEIs were recognized as the top information technology influencing China's accounting industry.

2.3 Driving Digital Transformation Across Sectors

We have promoted digital transformation in other industry sectors to bolster the building of Digital China. For instance, the STA and the Ministry of Finance have jointly issued guidelines with the Civil Aviation Administration of China and China State Railway Group to promote the use of FDEIs in the aviation and railway sectors. This has markedly enhanced the convenience of ticketing services. Additionally, the e-invoicing reform has spurred advancements in financial accounting processes such as electronic reimbursement, bookkeeping, and archiving. With coverage extending to hundreds of thousands of

pilot organizations, this initiative has streamlined crucial aspects of financial digitalization, powerfully driving the overall digital transformation of the economy and society.

2.4 Implementing Real-Time Dynamic Risk Management

We have implemented real-time dynamic risk prevention and control to uphold a fair business environment. FDEIs are driven by "data + rules", enabling real-time monitoring of risks throughout the entire process. This significantly enhances risk management capabilities, curbs illegal activities, and promotes compliance. Leveraging tax big data, smart systems automatically assign invoice quotas to taxpayers, reducing human intervention. As a result, the monthly increment of manual reviews for invoice quota has dropped by 85%, drastically cutting down on opportunities for rent-seeking behaviors and effectively mitigating integrity risks. This approach fosters a transparent and healthy relationship between tax authorities and enterprises.

2.5 Aligning with International Standards

We have aligned with international standards to promote high-level opening up. FDEIs align with the EU's PEPPOL technical standards for invoice operations. Through the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM), this alignment lays the groundwork for integrating China's e-invoice platform with those of related countries and regions. This facilitates smoother international operations for businesses looking to expand abroad or attract foreign investment. At the 2023 High-Level Symposium on the Digitalization and Digital Transformation of Tax Administration, delegates from 26 countries and regions as well as international organizations widely acknowledged that China's advancement in digitalizing tax administration through FDEIs has made remarkable progress.

3. Breakthrough Innovations

3.1 Revolutionizing Traditional Invoices with FDEIs

The introduction of FDEIs has brought about a revolutionary transformation of traditional invoices, achieving virtualization of carriers, substantial efficiency gains, scenario-based services, and intelligent management.

- **Virtual Invoice Carrier:** By eliminating the need for paper invoices, traditional operations such as printing, transporting, warehousing, distributing, and canceling paper invoices have become obsolete. The persistent issues of counterfeit and fraudulent paper invoices have almost vanished.
- **Unified Invoice Form:** Single-part invoices have replaced multi-part forms, putting an end to practices like filling out different parts of an invoice with varying amounts (such as

"yin-yang" invoices[1] or mismatched invoices, "top-heavy bottom-light" invoices or discrepant invoices).

➢ **Unique National Code:** The implementation of a nationwide invoice code system ensures that each invoice is uniquely generated in real-time by the information system, drastically reducing the opportunities for forgery and tampering.

➢ **Streamlined Invoice Types:** Furthermore, the consolidation of 17 types of invoices including full VAT invoices, simplified VAT invoices, and unified motor vehicle invoices into a single type of FDEIs simplifies the selection process. The system automatically matches the appropriate invoice type based on the taxpayer's business activities, resolving previous challenges related to choosing the correct invoice type.

➢ **Instant Invoice Delivery:** With FDEIs, the issuance and delivery of invoices are instantaneous. Taxpayers now have private digital tax accounts where they can receive and automatically collect invoice information in real-time. This makes complex tasks such as querying, analyzing, and summarizing invoices more straightforward and efficient. Gone are the days of time-consuming and anxiety-inducing processes like mailing invoices or worrying about receiving fake ones.

➢ **Pioneering Smart Taxation:** The successful promotion and application of FDEIs have also catalyzed the development of smart taxation. They have driven the digital, intelligent, and scenario-based development of the China's Golden Tax System Phase IV across three dimensions: taxpayers, tax staff, and decision-makers. This marks a significant shift from the past reliance on paper documents (and sometimes even a single document) to managing all aspects and scenarios across the entire domain.

3.2 Launching a World-Class Digital Identity System

We have launched China's largest and world-class unified digital identity system. A credible identity system within the tax network has been established, covering hundreds of millions of business entities and individuals. This system ensures trustworthy identities, traceable behaviors, accessible services, and effective supervision. It has become the largest government identity management platform for both organizations and individuals, positioning itself among the world-class digital identity systems.

3.3 Enhancing Tax Data Analysis with Smart Tools

We have developed agile and intelligent tax data analysis applications. By leveraging advanced technologies such as artificial intelligence and natural language processing, we have empowered our systems with data and algorithms to perform searches, statistical analyses, and data interpretations. This evolution has transformed the process from manually sifting through documents and relying on human efforts, to writing scripts for machine execution, and now to a more intuitive approach where users can effortlessly combine data elements and invoke commands through voice activation. As a result, the more the system is used, the better and more refined it becomes, fostering a cycle where improved functionality encourages even greater engagement and reliance on these tools.

3.4 Promoting China's Unique Tax Algorithms Globally

We are driving China's independent tax algorithms to gain international recognition. During the development of the e-invoice service platform and other next-generation tax information application platforms, we have innovated new tax algorithms such as the "2D+5C" model. Through platforms like the OECD Forum on Tax Administration and the BRITACOM, we are facilitating the transition of Chinese tax algorithms from followers to peers and leaders in the international arena.

1 "Yin-yang" invoices refer to issuing genuine invoices which reflect false economic transactions or do not reflect the actual situation of the economic transactions, thus forging the authenticity of the economic transaction.

Improving Tax Environment in the Republic of Tajikistan

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Abstract: This article analyzes key aspects of the development of Tajikistan's tax system, including challenges and opportunities for improving tax environment. It briefly examines the main directions of tax reform in the Republic of Tajikistan: a) improvement of tax legislation, especially adoption of the Tax Code in a new edition with the aim of improving tax administration, stimulating investments and creating more favorable conditions for businesses; b) enhancement of digitalization in tax administration, contributing to enhanced transparency in tax authorities' activities, reduction of administrative barriers, and simplification of interactions between tax authorities and taxpayers.

Keywords: Tax environment; Tax reform; Tax Code; Digitalization of tax administration

1. Introduction

In today's world, where the global economy is becoming increasingly interconnected, the creation of a stable, transparent, and fair tax environment requires countries to continuously improve both their tax legislation and tax administration mechanisms. These processes are particularly relevant in the context of the digital transformation of the economy, growing international competition, and the need to address global tax risks.

In this regard, as part of the ongoing tax reform in the Republic of Tajikistan and the implementation of the Tax Administration Development Program in the Republic of Tajikistan, and following the instructions of the Founder of Peace and National Unity — Leader of the Nation, President of the Republic of Tajikistan, His Excellency Emomali Rahmon, a new edition of the Tax Code was developed and adopted. Effective from 1 January 2022, the new Tax Code was adapted to current economic conditions, taking into account priority development areas, sector-specific characteristics, and modern international challenges such as tax evasion, base erosion and profit shifting to low-tax jurisdictions.

Among the key innovations are the reduction in the number of tax types from 10 to 7, lower rates for value-added tax (VAT), income tax for legal entities and individuals, as well as several other man-

datory payments. These measures were aimed at reducing tax burden, creating favorable conditions for business development, and enhancing the country's investment attractiveness.

A crucial element of the tax reform was the development of the Tax Administration Development Program for 2020–2025, approved by Resolution No. 643 of the Government of the Republic of Tajikistan dated 30 December 2019. This program serves as a strategic foundation for the digital transformation of the tax system, improving management efficiency, enhancing the quality of tax services, and fostering a partnership-based relationship between taxpayers and the state.

2. Tax Administration Development Program of the Republic of Tajikistan for 2020–2025: Transition to a Digital, Transparent and Service-Oriented Economy

The Tax Administration Development Program of the Republic of Tajikistan for 2020–2025 (hereinafter referred to as "the Program") was developed in accordance with the priority areas and goals of the National Development Strategy until 2030, drawing on best international practices.

The concept of the Program includes the development of a modern tax system based on the principles of transparency, digitalization, partnership with taxpayers, and improvement of the business environment. The Program serves as a foundation for increasing the efficiency of tax administration and creating favorable conditions for sustainable economic growth and investment activity.

The goal of the Program is to improve the tax administration system, enhance the transparency of tax authorities' operations, improve tax services, digitize processes, and establish partnership-based relations between taxpayers and tax authorities.

The development of tax administration is seen as a key element of economic reforms aiming at:

- Improving the business environment and investment climate;
- Increasing the competitiveness of national economy; and
- Promoting digital transformation and reducing the shadow economy.

Main objectives of the Program are as follows:

- Improving inter-agency cooperation;
- Assessing the impact of tax rates and benefits on the state budget;
- Reducing the administrative burden for compliant taxpayers;
- Stimulating investment and entrepreneurial activity;
- Lowering business costs for tax compliance;
- Implementing digital solutions and minimizing human involvement;
- Developing tax monitoring and online control systems; and
- Increasing taxpayers' tax literacy and legal awareness.

Key areas of implementation are:

- Digitalization of tax administration and the introduction of automated processes;
- Development of remote interaction with taxpayers and government agencies;
- Improving tax discipline and the quality of tax services; and
- Creating a healthy competitive environment and legalizing the shadow economy.

Expected outcomes:

- Significant reduction in the time and costs for taxpayers to fulfill their tax obligations;
- Transition to paperless document management and electronic interaction;
- Increase in voluntary tax compliance;
- Expansion of the tax base and budget revenues; and
- Creation of favorable conditions for the development of small and medium-sized businesses.

The Program is an important step towards creating a transparent, modern, and taxpayer-oriented tax administration system that meets challenges of the digital economy.

From 2020 to 2025, significant efforts were made to achieve the goals and objectives of the

Program.

In particular, a new edition of the Tax Code of the Republic of Tajikistan was developed and enacted, and around 100 regulatory legal acts, instructions, and tax reporting forms were prepared and improved. Special attention was given to expanding the range of services for taxpayers, including the implementation of new digital modules to enhance the effectiveness of tax control and data analysis.

A large-scale reform of tax risk management system was carried out, including the introduction of a mechanism for VAT refunds based on risk assessment. To support entrepreneurs, more than 30,000 cash registers were provided to them free of charge.

Considerable attention was paid to improving taxpayer service standards, which were revised based on feedback and suggestions from taxpayers. A mobile application called "*Andozi Man*" ("My Tax") was developed and launched, offering extensive capabilities for interaction with tax authorities.

As a result of these measures, the number of taxpayers submitting tax reports electronically and the registration of new businesses increased significantly. At the same time, tax and fee revenues collected by tax authorities consistently exceeded the state budget targets, indicating improved tax administration efficiency and higher tax compliance.

3. Evolution of the Tax System of the Republic of Tajikistan: From Establishment to Digital Transformation

The tax system of the Republic of Tajikistan has gone through several sequential stages of development and transformation, reflecting both internal socio-economic changes and the demands of the times as well as international practices.

Stage I (1991–2005): Formation of the Tax System

This period marked the establishment of tax legislation during the transition to a market economy. Key achievements include:

- Creation of the legal framework for the tax system;
- Adoption of the first Tax Code of the Republic of Tajikistan (1999); and
- Development of regulatory legal acts on the calculation and payment of taxes.

Stage II (2005-2013): Improvement of Tax Legislation

As a result of analyzing the implementation of the first Tax Code, several legal gaps and inconsistencies were identified. Based on the recommendations of domestic and international experts, as well as proposals from businesses and relevant authorities, the following measures were taken:

- A new edition of the Tax Code was adopted (2005);
- Tax regulations were optimized; and
- Legal guarantees for taxpayers were strengthened.

Stage III (2013-2020): Digitalization and Modernization of the Tax System

This stage focused on the technological transformation of tax administration:

- A new edition of the Tax Code was adopted with an emphasis on simplifying procedures;
- The number of taxes was reduced by 50%, and reporting forms by 40%~80%;
- Electronic tax services were introduced; and
- The transition to digital tools for interaction with taxpayers began.

Stage IV (2020–2025): Comprehensive Reform and Digital Transformation

Since 2020, the Republic of Tajikistan has been implementing the Tax Administration Development Program for 2020–2025. The main objectives of the Program are:

- Simplification of tax procedures;
- Digitalization of tax administration;
- Enhancing transparency and building trust between taxpayers and tax authorities;
- Improving business environment and investment climate; and
- Reducing administrative burden on businesses.

A key achievement of this stage was the adoption of the new edition of the Tax Code, which came into force on 1 January 2022.

4. Tax Code of the Republic of Tajikistan in a New Edition: A Step Towards Improving Tax System and Stimulating the Economy

In recent years, with the assistance of international financial institutions, primarily the World Bank and development partner countries, the Republic of Tajikistan has achieved certain successes in improving tax environment through the implementation of the Tax Administration Development Program for 2020-2025.

Perhaps the most significant development at the current stage of the tax system's evolution in this direction was the adoption and implementation of the Tax Code in a new edition, developed based on accumulated domestic experience and using the best practices of other countries, in cooperation with the private sector and international financial organizations.

The Tax Code in a new edition establishes a qualitatively new framework for the organizational, legal, and economic foundations related to the introduction, modification, cancellation, calculation, and payment of taxes, as well as the development and stimulation of economic activity.

It should be reminded that in the previous editions of the Tax Code of the Republic of Tajikistan, taxation was generally determined based on widely accepted principles of taxation, such as legality, obligatoriness, justification of taxation, fairness, unity of the tax system, and transparency.

Noticeably, a qualitative distinction of the Tax Code in a new edition from previous versions lies in the introduction of a dedicated chapter on taxation principles aimed at improving tax environment and tax certainty. It also includes several significantly new provisions reflecting the current state of tax relations and administration, such as:

- provisions on the pre-trial dispute resolution council, which should be composed of representatives from ministries and agencies, business associations, experts, and independent consultants;
- provisions on commissions for addressing and resolving tax avoidance issues; and
- provisions for the introduction of tax monitoring, which replaces traditional tax audits with online interactions based on remote access to the taxpayers' information systems and their accounting and tax reports.

At the same time, the number of tax types has been reduced from 10 to 7 (including 6 republican taxes and 1 local tax). Tax rates have also been reduced, including:

- VAT: Reduced from 18% to 14% (and to 13% starting from 2027);
- Corporate income tax: Lowered from 23% to 20% (for the activities of credit and financial institutions and mobile network operators), 13% (for activities related to the production of goods), and 18% (for the extraction and processing of natural resources and all other related business activities);
- Social tax: Decreased from 25% to 20%;
- Income tax for non-residents: Reduced from 25% to 20%;
- Preferential VAT rates:
  - 7% for construction, hospitality, and catering;
  - 5% for domestic agricultural products, education, and healthcare;
- Tax Incentives:
  - Exemption from profit tax for new industries and tourism for up to 5 years;
  - Benefits for light industry, pharmaceuticals, "green" and digital economy sectors;
  - Exemption from taxes for subjects in free economic zones (except taxes withheld at the source of payment).

Regarding innovations in the new version of the Tax Code, it is important to highlight that, in light of the current realities of the high-tech world, a simplified taxation system has been introduced to support the development of innovation and technological activities and accelerate the digital transformation of national economic sectors. Under this system, subjects in this sector are exempt from all taxes (except for personal income tax and social tax on income from labor activities, for which a 50% exemption is provided).

5. Digitalization of Tax Administration: A Path to Ensuring Transparency and Efficiency Within the Tax Authorities of the Republic of Tajikistan

In the Tax Committee of the Government of the Republic of Tajikistan, as part of the practical implementation of the concept of digital economy and the Program, most of the public services provided to taxpayers and citizens are carried out using modern information technologies in an electronic format.

One of the main objectives of the Program is to improve the service provided to taxpayers and citizens, enhance their compliance with tax legislation, refine tax administration, and improve interaction with as well as feedback from taxpayers through the enhancement of digitalization within tax authorities. It is clear that the digitalization in tax authorities has led to its recognition as a key development direction. It is also evident that one of its main advantages lies in the ability to provide tax services remotely. Taxpayers don't need to physically visit tax authorities or directly interact with their employees. It should also be emphasized that digitalization facilitates modern exchange of information between government agencies, significantly enhances the efficiency of their operations, including improving the performance of tax authorities.

The Tax Committee places special emphasis on building trust-based relationships with taxpayers and continuously works to improve the quality of feedback mechanism. To enhance convenience and transparency, all taxpayers' inquiries to the headquarter of the Tax Committee and local tax authorities are accepted electronically through the "Taxpayer Personal Account". Responses to inquiries are also sent electronically through the personal account, ensuring prompt and convenient interaction. Nowadays, the Tax Committee provides taxpayers and citizens with over 40 state electronic services through modern electronic modules. Among them are: electronic submission of tax returns, business registration within 24 hours, use of the "Virtual Warehouse" system, issuance of electronic VAT invoices, and payment of taxes through mobile applications. This significantly simplifies interaction with tax authorities, increases transparency in taxpayers' fulfillment of their tax obligations, and reduces the time they spend on compliance.

The unification of business processes in tax control through the use of the "Virtual Warehouse of the Taxpayer" service allows for the efficient tracking of the entire VAT chain, promptly identifying discrepancies and preventing fraudulent activities. This, in turn, encourages taxpayers to create a transparent tax environment and voluntarily comply with their tax obligations.

The implementation of the "Virtual Warehouse" service and the mechanism for preparing electronic invoices significantly reduce the administrative burden on businesses, including simplifying export operations, and also allow for a reduction in the time and labor costs for taxpayers. This tool ensures the transparency of transactions between companies, with all operations automatically reflected in tax reporting, simplifying the process of interaction with tax authorities.

For proper VAT administration, the Tax Committee has developed and implemented electronic VAT invoices (since July 2015) with the following functionalities: issuing invoices in electronic format, automatic generation of VAT declarations based on VAT invoices, printing or saving invoice templates, transmitting invoice data from one taxpayer to another automatically, submitting requests for the cancellation of invoices and automatically cancelling them in electronic format, and more.

All tax invoices are available in electronic format, both for taxpayers and tax officers. Overall, these capabilities have significantly improved VAT administration and greatly facilitated interaction with taxpayers, while also contributing to the reduction of informal economic activities.

The automated VAT control system automatically verifies data from electronic invoices and VAT declarations, comparing the information of the taxpayer and their counterparties. The system allows for the construction of relationship graphs, creating a visual representation of trade and financial relationships between taxpayers to

identify potential risks in VAT chains and the evasion of fair VAT payments to the budget.

A mobile application called "*Andozi Man*" has been developed and launched, providing extensive opportunities for interaction with tax authorities. With its help, taxpayers can:

- Register and log into their personal account using a password or biometric data (fingerprints, Face ID);
- Receive and view messages from the Tax Committee;
- Use the tax calculator;
- Track information about properties owned; and
- Access other useful functions in a digital format.

It should be noted that in 2022, with the assistance of the Organisation for Economic Co-operation and Development (OECD), the Tax Committee of the Government of the Republic of Tajikistan participated in a self-assessment of the digital transformation maturity model across 6 dimensions of digital maturity, including the description of the digital identity, taxpayer touchpoints, data management and standards, tax rule management and application, new skill sets and governance frameworks.

After the completion of the self-assessment, the OECD reported that the Tax Committee of the Government of the Republic of Tajikistan is at an above-average level of digital transformation maturity compared with other tax jurisdictions, and some tax jurisdictions have expressed interest in starting cooperation with us in this area.

6. Conclusion

In summary of the brief review of the improvement of tax legislation in the context of new realities and the digitalization process of tax administration in the Republic of Tajikistan, it should be noted that the measures adopted in these areas are primarily aiming at improving business and investment environment in the country. These efforts, in turn, contribute to economic growth and the improvement of the population's standard of living.

A special significance in this process is the participation of Tajikistan in international initiatives with the objective of improving tax environment and strengthening cooperation between jurisdictions. A prominent example is the Republic's participation in the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM), including active participation in the Fifth Belt and Road Initiative Tax Administration Cooperation Forum and a Theme Day Event dedicated to the tax system of the Republic of Tajikistan.

Tajikistan demonstrates a desire not only to improve the domestic tax environment but also to develop international cooperation, which is especially relevant in the era of globalization and digital transformation.

Overall, the implemented reforms in tax policy and administration, as well as the introduction of digital technologies, create favorable conditions for doing business and attracting investments. An important element of these changes is the increase in tax transparency and the improvement of interaction with taxpayers through electronic services and platforms.

It is noteworthy that the measures taken in recent years in the Republic of Tajikistan to improve tax policy, enhance administration, and expand the digitalization of the sector have received positive assessments from international organizations.

In particular, the OECD's 2020-2023 report "Improving the Legal Environment for Business and Investment Activities in Central Asian Countries" highlighted that tax administration in the Republic of Tajikistan has improved due to ongoing digitalization and enhanced public-private dialogue.

Recognizing the importance of improving the tax environment, the Tax Committee will continue to actively cooperate with the tax authorities of other countries both bilaterally and within the framework of international organizations.

The Tax Committee of the Government of the Republic of Tajikistan intends to prioritize its efforts on improving and simplifying tax legislation, enhancing tax administration, and raising tax literacy among citizens and taxpayers, and further digitalize the sector.

Achievements and Experience in Improving Tax Environment in Hong Kong SAR, China

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Abstract: Renowned for its robust and efficient tax environment, the Hong Kong Special Administrative Region of China (Hong Kong) maintained its position among the global top three in "tax policy" for the past five years, as reported in the *World Competitiveness Yearbook* published by the International Institute for Management Development. This article delves into the key achievements and experience of Hong Kong in enhancing its tax environment, focusing on four critical areas: staying aligned with global trends to remain competitive; upholding high standards in the formulation of tax legislation; enhancing quality and accessibility of tax administration services; and ensuring operational efficiency of the tax system.

Keywords: Tax environment; Tax legislation; Tax administration; Tax system; Tax policy; GloBE

1. Introduction

For decades, the Hong Kong Special Administrative Region of China (Hong Kong) has been recognised as owning one of the world's most business-friendly tax systems in the world. Over the past five years, it has consistently ranked among the global top three in "tax policy", according to the *World Competitiveness Yearbook* by the International Institute for Management Development.[1] Hong Kong's tax regime is simple, taxing

1 The IMD *World Competitiveness Yearbook* ranked the competitiveness of over 60 economies based on four factors: economic performance, government efficiency, business efficiency and infrastructure. These factors capture various aspects of competitiveness, such as macroeconomic stability, fiscal policy, institutional quality, market openness, business dynamism, innovation, education, health and environmental performance. "Tax policy" is one of the sub-factors under "government efficiency", which evaluates tax policy efficiency across different jurisdictions. This evaluation considers factors such as tax structures, compliance, and the impact of taxation on economic performance. The rankings provide insights into the effectiveness and efficiency of tax policies in promoting economic competitiveness. The Yearbook can be accessed via this page: https://www.imd.org/centers/wcc/world-competitiveness-center/rankings/world-competitiveness-ranking/.

only three specific types of income, namely business profits, salaries income and property income. Tax is imposed only on profits/income arising in or derived from Hong Kong. The headline profits tax rate for corporations is 16.5% (with a reduced rate of 8.25% on the first HKD2 million of assessable profits under the two-tiered profits tax rates regime), and the maximum salaries tax charged is 16% of the net income without allowances. Notably, in Hong Kong there is no sales tax or goods and services tax.

The simple tax regime, coupled with low tax rates, has been crucial in supporting Hong Kong's economy and fostering a business-friendly environment that attracts both local and foreign investments.

The ability to withstand challenges over time and adapt to the evolving international landscape is rooted in four key elements: (i) staying aligned with global trends to remain competitive; (ii) upholding high standards in the formulation of tax legislation; (iii) enhancing quality and accessibility of tax administration services; and (iv) ensuring operational efficiency of the tax system.

These elements collectively reinforce Hong Kong's robust tax system, further solidifying its position as a leading business and investment hub. By continuously evolving and improving, Hong Kong maintains its attractiveness to investors and businesses, ensuring long-term economic stability and growth.

This article will delve into the four elements cited above, examining how each contributes to Hong Kong's resilience and adaptability in the face of global challenges.

2. Staying Aligned with Global Trends to Maintain Competitive

2.1 Introducing Sector-Specific Tax Incentives

The intense competition from neighbouring jurisdictions has underscored the need for Hong Kong to diversify its economic base. To promote the business sectors and industries where Hong Kong enjoys competitive advantages, the government has introduced various sector-specific tax incentives in the last decade to address the specific needs of individual sectors. For example, the following sector-specific tax incentives have been implemented to foster growth in targeted industries.

2.1.1 Innovation and technology industry

• Patent box regime: A 5% concessionary tax rate applies to the concessionary portion of a taxpayer's assessable profits derived from eligible intellectual property (IP) income.

• Enhanced tax deduction regime for qualifying research and development (R&D) expenditures: A 300% deduction is available for the first HKD2 million of the aggregate amount of payments made to "designated local research institutions" for qualifying R&D activities (i.e., outsourced qualifying R&D) and qualifying expenditures incurred by the taxpayer itself (i.e., in-house qualifying R&D). A 200% deduction is available for the remaining amount.

2.1.2 Asset and management services

• Tax concessions for family-owned investment holding vehicles: A 0% concessionary tax rate is provided on the assessable profits earned from qualifying transactions and incidental transactions (the latter being subject to a 5% threshold) for an eligible family-owned investment holding vehicle managed by an eligible single family office in Hong Kong.

• Tax exemption for investment funds: Publicly offered funds regulated by the Securities and Futures Commission of Hong Kong and similar bona fide widely held investment schemes complying with an acceptable regulatory regime are exempt from profits tax in Hong Kong. Privately offered funds are also exempt from profits tax on specified transactions, provided that certain conditions are met.

• Tax concessions for carried interest: A 0% concessionary tax rate applies to eligible carried interest derived by qualifying entities from the provision of investment management services for certain funds. In addition, the concession excludes 100% of eligible carried interest derived by qualifying individuals from employment with a qualifying entity that provides investment

management services for certain funds from salaries tax.

2.1.3 Aviation and maritime industries

• Aircraft leasing tax regime: An 8.25% concessionary tax rate (i.e., half of the headline profits tax rate) applies to the qualifying profits of qualifying aircraft lessors and qualifying aircraft leasing managers. Additionally, qualifying aircraft lessors would be allowed a full deduction for the acquisition cost of aircraft.[2]

• Ship leasing tax regime: A 0% concessionary tax rate applies to the qualifying profits of qualifying ship lessors, while an 8.25% concessionary tax rate generally applies to the qualifying profits of qualifying ship leasing managers.

• Tax concessions for shipping-related activities: Qualifying shipping commercial principals, namely ship agents, ship managers and ship brokers, are either exempt from tax or subject to a 0% or an 8.25% concessionary tax rate on their qualifying profits.

2.2 Aligning with International Tax Developments

The government of Hong Kong SAR has always been supportive of international efforts to enhance tax transparency and combat tax evasion. To fulfil its obligation as a cooperative player in international tax cooperation and safeguard Hong Kong's taxing rights, significant changes have been and will be made to the tax code of Hong Kong.

2.2.1 Refinements to the foreign-sourced income exemption (FSIE) regime

In October 2021, Hong Kong was added to the European Union (EU) watchlist regarding international tax cooperation as the EU was concerned that under the FSIE regime, there could be circumstances under which corporates with no substantial economic activity in Hong Kong would not be subject to tax in respect of certain foreign-sourced passive income (such as interest and royalties), hence leading to situations of "double non-taxation".

In response, the government of Hong Kong SAR enacted legislative amendments in December 2022 to refine and strength the FSIE regime against cross-border tax avoidance. Under the refined FSIE regime which came into operation from 1 January 2023, four types of foreign-sourced income, namely (i) dividend, (ii) interest, (iii) IP income and (iv) disposal gain from the sale of equity interests, are deemed to be sourced from Hong Kong and chargeable to profits tax if the income is received in Hong Kong by a multinational enterprise (MNE) carrying on a trade, profession or business in Hong Kong, unless the MNE satisfies the relevant exception requirement.

Shortly before the aforesaid legislative amendments were passed by the legislature, the EU updated its guidance to explicitly require an FSIE regime to include capital gains as a general class of income. The government of Hong Kong SAR has further refined the FSIE regime to expand the scope of covered income to include disposal gain on other types of assets (in addition to equity interests) to align with the latest EU guidance with effect from 1 January 2024. Nonetheless, additional mitigating measures were added to reduce the compliance burden of MNEs affected by the FSIE regime.

In recognition of Hong Kong's efforts in ensuring that its FSIE regime is in full compliance with the EU's relevant requirements, Hong Kong was removed from the updated watchlist published in February 2024.

2.2.2 Proposed implementation of the global minimum tax and domestic minimum top-up tax

In July 2021, Hong Kong, together with more than 130 jurisdictions across the globe, pledged to implement the international tax reform framework of a two-pillar solution drawn up by the Organisation for Economic Co-operation and Development (OECD). The goal of the global anti-base erosion (GloBE) rules under Pillar Two is to ensure that large MNE groups

2 A transitional arrangement exists under which aircraft acquired in a year of assessment preceding the year of assessment 2023/24 may opt to continue being taxed on a 20% tax base concession if relevant conditions are met.

with consolidated annual revenue of at least EUR750 million pay a global minimum tax of at least 15% on income derived by their constituent entities in every jurisdiction where they operate, thereby putting a floor on competition over corporate income tax.

The government of Hong Kong SAR conducted a three-month public consultation on the implementation of the GloBE rules and the Hong Kong minimum top-up Tax between December 2023 and March 2024. The consultation focused mainly on the design features that are relevant to Hong Kong and invited views on matters that are left for consideration by Hong Kong as the implementing jurisdiction.

In late October 2024, the government of Hong Kong SAR released the consultation outcome, indicating that the upcoming legislative bill will adopt several favourable recommendations from stakeholders to facilitate a smooth transition for in-scope MNE groups while ensuring that Hong Kong's proposed regimes remain compliant. The final legislation, enacted in June 2025, incorporates several recommendations to address both the drafting and substantive effects of its provisions, responding to stakeholder concerns and ensuring that the law operates as intended.

Sound tax policy decisions should be underpinned by clear and well-defined legislation. Effective tax legislation not only ensures compliance but also establishes a stable framework that promotes economic growth and innovation.

3. Upholding High Standards in the Formulation of Tax Legislation

3.1 Consistent and Equitable Taxation

Hong Kong has adhered to a simple and territorial taxation system since the enactment of its tax law in 1947. This principle has remained unchanged despite the evolving business and international tax landscape. The stability of this system ensures that taxpayers can plan their tax liabilities with confidence, knowing that the fundamental principles of taxation will not change unpredictably.

Fairness is also a cornerstone of Hong Kong's tax system. Within the bounds of neutrality and a level playing field, allowable deductions and tax concessions are provided to all individuals and companies chargeable to profits tax in Hong Kong, irrespective of their resident status. This combination of stability, predictability and fairness makes Hong Kong's tax system both reliable and equitable for all taxpayers.

3.2 Transparent Legislative Process

The legislative process in Hong Kong is characterised by a high degree of transparency. This transparency is achieved through a series of public and industry consultations that are integral to the development and refinement of laws.

Before introducing new tax laws or making enhancements to existing ones, the government of Hong Kong SAR typically engages in extensive consultations with stakeholders. This approach ensures that the interests of various stakeholders are considered and balanced. The consultation process involves gathering feedback, providing detailed explanations of the policy rationale behind proposed legislation, submitting the proposed legislation to the Legislative Council for thorough deliberation, and encouraging interested parties to submit their views and opinions on the proposed legislation. All relevant documents related to the legislative process are publicly accessible, ensuring that the process remains open and transparent.

A notable example of this transparent process is the refinement of the FSIE regime. The government of Hong Kong SAR and the Inland Revenue Department (IRD) conducted several rounds of consultations with stakeholders. They carefully considered the feedback received and made efforts to accommodate the concerns and suggestions of various parties. This collaborative approach has led to a regime that better aligns with business needs.

3.3 Publication of Tax Case Decisions and Judgments

Hong Kong adopts a common law system, which is characterised by its reliance on case precedents. The doctrine of precedent mandates

that like cases be treated alike, thereby ensuring consistency and predictability in the decisions of the courts. Tax tribunal decisions and court judgments are easily accessible online, providing clarity on the interpretation of relevant legislation in various circumstances. This accessibility ensures uniformity in tax treatment and aids businesses in better understanding their tax obligations. By maintaining a transparent and predictable legal framework, Hong Kong's common law system supports a stable and reliable business environment.

Following the enactment of tax legislation, it is incumbent upon the IRD, as the administrator of tax legislation, to maintain the highest standards of quality and accessibility of tax administration services. This responsibility also includes ensuring the operational efficiency of the tax system in practice.

4. Enhancing the Quality and Accessibility of Tax Administration Services

4.1 Guidance on Application of Tax Laws

Effective communication is essential as it serves to enhance general tax knowledge, helps the public understand their tax obligations and eventually encourages voluntary compliance. To this end, the IRD provides a wide range of tax information, guidance and frequently asked questions on its website. The Departmental Interpretation and Practice Notes (DIPNs) are regularly issued by the IRD to outline its interpretation of applicable tax laws and practices related to important tax issues. In recent years, the IRD also provides online guidance upon the gazettal of a legislative bill or new legislation to clarify the newly implemented changes. The timely release of such guidance enables taxpayers to better understand and comply with their tax obligations.

4.2 Annual Meetings with Industry Representatives

The IRD holds annual meetings with the Hong Kong Institute of Certified Public Accountants to clarify technical matters related to emerging tax issues and exchange views on various tax administration issues. The minutes of these meetings are published online, offering taxpayers insights into the IRD's interpretation and application of relevant tax laws. These resources are invaluable for taxpayers, providing them with greater clarity and certainty.

4.3 Advance Tax Ruling

The IRD operates an advance ruling system, allowing taxpayers to apply for a ruling on how the tax law applies to them or their proposed transactions. Once a ruling is given, it is binding on both the taxpayer and the Commissioner of IRD, provided certain conditions are met. This service provides taxpayers with a degree of certainty about the application of tax law to their arrangements, promotes consistency and minimises tax disputes, which can be lengthy and costly.

With the introduction of the refined FSIE regime, the IRD also allows taxpayers to obtain an advance ruling to determine if they meet economic substance requirements. This application can cover up to five years of assessment, offering a relatively long period of certainty and easing subsequent reporting requirements, thereby reducing tax compliance burdens.

4.4 Flexibility in Tax Filing and Payments

To enhance the flexibility of tax compliance procedures, the phased implementation of electronic filing (e-filing) of tax returns has recently been introduced, starting with voluntary e-filing and gradually transitioning to mandatory e-filing for all taxpayers. This approach provides taxpayers with ample time to familiarise themselves with the new tax filing process and requirements. Interested taxpayers and service providers were invited to participate in trial runs and were encouraged to provide feedback and suggestions, enabling the IRD to further refine the tax portal before its official rollout. Additionally, multiple online tax payment options simplify compliance for businesses, allowing them to manage their tax affairs more efficiently.

4.5 Streamlining Tax Assessing Procedures

The efficiency of the IRD's review of tax returns is exemplified by its "assess first, audit later" system. This system uses an analytical solution to screen tax returns, issue tax assessments first, and then select cases for post-assessment audits and investigations. By considering compliance trends and past audit findings, risk factors are assigned to different items annually to ensure that high-risk returns are selected for audits. Streamlining the assessment process enables businesses to receive their tax assessments promptly and allows the IRD to collect tax payments more efficiently.

4.6 Accessibility

Accessibility is another key area that benefits taxpayers in Hong Kong. Businesses can easily contact IRD officers directly via phones or emails for any inquiries about their tax position or areas of uncertainty. The IRD officers are quick to respond and strive to offer help to resolve any tax issues.

4.7 Clear Appeal Process for Tax Audits and Investigations

A clear appeal process for tax audits and investigations encourages voluntary compliance and reduces tax evasion. Protecting taxpayers' rights and promoting accountability through legal protections and oversight ensures a just system, thereby fostering a more effective and equitable tax system and enhancing the quality and accessibility of tax administration services.

5. Ensuring Operational Efficiency of the Tax System

5.1 Establishment of a Large Business Office (LBO)

The establishment of an LBO within the IRD ensures operational efficiency by centralising the management of large businesses. This approach ensures that entities within MNE groups are assessed in a coordinated and consistent manner, enhancing the overall integrity and efficiency of the tax system. It also fosters better communication and reduces disputes, ensuring a more effective and efficient tax system overall.

5.2 Public-Private Collaboration

As mentioned above, the government of Hong Kong SAR engages stakeholders in the formulation of tax legislation. Such public-private collaboration helps identify potential compliance challenges and administrative burdens, allowing for the creation of more streamlined and effective tax regulations. Ultimately, this partnership ensures that tax policies are both practical and efficient, benefitting the overall economy.

5.3 Digitalisation

The introduction of e-filing and diverse tax payment methods in Hong Kong has significantly enhanced the operational efficiency of the tax system. E-filing reduces physical paperwork and expedites processing time, thereby minimising errors and ensuring swift and accurate tax return processing. Multiple payment options cater to different taxpayers' preferences, facilitating timely payments and improving compliance rates. Collectively, these advancements reduce administrative burdens and allow the IRD to allocate resources more effectively. By leveraging technology and offering diverse payment methods, Hong Kong's tax system has become more efficient and user-friendly.

6. Conclusion

Hong Kong's tax system is renowned for its quality, clarity and commitment to stability and fairness. By aligning with international standards and encouraging collaboration between the public and private sectors, Hong Kong provides robust support to taxpayers and sustains a stable tax environment for business operations. Continuous efforts to enhance the tax environment through transparent legislative processes, efficient tax administration services and meticulous implementation ensure that Hong Kong remains a competitive and attractive destination for businesses worldwide.

Optimizing Tax Service and Streamlining Tax Compliance:
Tailored Interventions at ZATCA, Saudi Arabia

Zakat, Tax and Customs Authority

هيئة الزكاة والضريبة والجمارك
Zakat, Tax and Customs Authority

Zakat, Tax and
Customs Authority
Saudi Arabia

Abstract: This article explores the integration of behavioral science in optimizing tax services and streamlining tax compliance for VAT return filing under the Zakat, Tax and Customs Authority (ZATCA). ZATCA implemented six behavioral interventions designed to simplify the process for distinct taxpayer personas: bundlers, patterned filers, and irregular filers. These interventions were grounded in evidence-based behavioral insights and rigorously tested through randomized experiments on a diverse sample of taxpayers based on their historical filing patterns. The results showed significant improvement in on-time filing rates, with increases of 3 to 15 percentage points compared with control groups. The article demonstrates behavioral science can optimize tax services by reducing complexity and promoting voluntary compliance through simplified interventions. The findings provide a replicable framework for addressing similar challenges in tax administration globally, contributing to the ongoing efforts to streamline tax compliance and improve governance practices.

Keywords: Behavioral nudges; Behavioral science; Behavioral interventions; Scarcity messaging; Deterrence strategies; Social norms; Tax policy; Tax service; Tax compliance

1. Introduction

Effective tax administration is essential for fostering economic growth, ensuring equitable revenue collection, and enhancing taxpayer trust. Optimizing tax services and streamlining tax compliance are key priorities for modern tax authorities, particularly in simplifying processes and reducing administrative burdens.

Global research on tax compliance highlights that simplifying processes, enhancing taxpayers' engagement, and leveraging behavioral insights can significantly improve compliance rates. Studies from the UK, Chile, and Latin America suggest that reducing procedural complexity, increasing awareness, and addressing motivational barriers can lead to higher voluntary compliance (Hallsworth et al., 2014;

Pomeranz, 2015; Del Carpio, 2013).

This article examines the Zakat, Tax and Customs Authority's (ZATCA's) approach to optimizing tax services through six behavioral interventions targeted at distinct taxpayer personas — bundlers, patterned filers, and irregular filers. By leveraging data-driven insights and behavioral science, these interventions seek to streamline tax compliance, reduce late filings, and enhance the overall taxpayers' experiences. The findings contribute to best practices in regulatory innovation and highlight the role of behavioral strategies in modern tax administration.

2. Background

This section explores the challenges of tax compliance, the role of behavioral science in simplifying tax obligations, and global benchmarks that informed ZATCA's service optimization strategies. By contextualizing these challenges and drawing lessons from international experience, this section provides a comprehensive foundation for understanding ZATCA's behavioral interventions and their potential impact.

2.1 Tax Compliance Challenges

Ensuring tax compliance is crucial for efficient revenue collection and economic stability. However, many taxpayers face barriers that hinder timely and accurate filings, increasing administrative burdens and reducing efficiency. The key challenges include:

• **Lack of urgency**: Many taxpayers deprioritize tax filing, perceiving deadlines as flexible and penalties as minimal, fostering complacency.

• **Awareness gaps**: Misunderstandings about filing deadlines, requirements, and available services are common, particularly among small and medium enterprises (SMEs) with limited resources.

• **Perceived complexity**: Filing tax returns requires navigating intricate processes, which can be daunting for taxpayers, especially smaller entities. This complexity often leads to procrastination and non-compliance.

These challenges collectively lead to delayed filings, inefficient cash flow, and higher administrative costs for tax authorities.

2.2 Behavioral Science in Tax Service Optimization

Behavioral science offers innovative approaches to enhancing tax compliance by addressing the cognitive and psychological factors influencing taxpayers' behaviors. Unlike traditional enforcement mechanisms, behavioral interventions reshape the decision-making environment to make compliance more intuitive and accessible.

Key behavioral principles include:

• **Salience**: Highlighting critical information, such as filing deadlines and key steps, helps taxpayers prioritize compliance.

• **Social norms**: Emphasizing that most taxpayers comply on time encourages others to follow suit.

• **Scarcity**: Stressing limited time before deadlines creates urgency and reduces procrastination.

• **Deterrence**: Communicating financial and legal consequences of non-compliance disrupts complacency and motivates timely action.

These principles informed ZATCA's interventions, ensuring that simplifications addressed specific behavioral barriers to tax compliance.

2.3 Global Benchmarks and Best Practices

ZATCA's approach was inspired and guided by global best practices that demonstrated the effectiveness of behavioral nudges in improving tax compliance.

• **Chile**: Timely reminders emphasizing audit risks increased VAT compliance by 12 percentage points (Pomeranz, 2015).

• **UK**: Social norm messaging highlighting high compliance rates among peers boosted tax payments by 15 percentage points (Hallsworth et al., 2014).

• **Peru**: Simplifying filing instructions improved accuracy and compliance by 10 percentage points (Del Carpio, 2013).

• **Guatemala**: Behavioral letters incorporating social norms and deterrence messaging increased tax declarations by 10 percentage points (Kettle et al., 2016).

These insights shaped ZATCA's tax service optimization strategy, ensuring that its interventions were tailored to taxpayers' needs.

3. Methodology

This section outlines the taxpayer segmentation, intervention design, and evaluation metrics used to measure effectiveness. In recent years, ZATCA employed behavioral science principles and rigorous experimental design to evaluate the impact of targeted interventions on tax compliance.

3.1 Taxpayer Segmentation and Sampling

Using historical compliance data, taxpayers were segmented into three behavioral profiles to ensure targeted interventions:

- **Bundlers**: Delay multiple filings and submit them simultaneously, driven by a perception that bundling carries minimal consequences;
- **Patterned Filers**: Exhibit late filing patterns during specific operational cycles, driven by habitual procrastination; and
- **Irregular Filers**: File sporadically due to awareness gaps and ad hoc operational challenges.

A randomized controlled trial framework was used, where taxpayers were randomly assigned to treatment and control groups.

3.2 Tax Service Optimization Interventions

Six behavioral interventions were designed to simplify compliance and enhance service efficiency:

- **Scarcity Messaging**: Reminders emphasizing limited time before deadlines to create urgency;
- **Flexible Payment Options**: Information on installment plans to alleviate cash flow concerns;
- **Social Norm Messaging**: Highlighting high compliance rates among peers to encourage timely filing;
- **Simplification**: Providing a step-by-step checklist to reduce perceived complexity;
- **Deterrence for Bundlers**: Emphasizing financial and legal risks of delayed filings; and
- **Deterrence for Patterned Filers**: Addressing habitual late filing with cumulative risk messaging.

Each intervention was aligned with taxpayer personas to ensure relevance and effectiveness.

3.3 Evaluation Metrics

To measure the impact of the interventions, the article tracked:

- **Primary Outcome**: On-time filing rates before and after the intervention; and
- **Secondary Outcomes**:
  - ➢ Sustained compliance over multiple filing periods;
  - ➢ Taxpayers' engagement with simplified digital services; and
  - ➢ Administrative efficiency improvements in processing compliance.

By optimizing tax services and streamlining compliance, these interventions aimed to enhance taxpayers' experiences, reduce administrative burdens, and improve overall compliance rates.

4. Randomized Controlled Trial Design

A randomized controlled trial framework was used to assess the causal impact of the interventions. Taxpayers were randomly assigned to one of the two groups:

- **Treatment group**: Taxpayers received one of the six behavioral interventions tailored to their identified persona.
- **Control group**: Taxpayers received standard communications with no behavioral enhancements, serving as a baseline for comparison.

Randomization ensured balanced representation across key taxpayers' characteristics, including industry type, filing volume, and compliance history. This approach minimized potential biases and enhanced the internal validity of the findings.

4.1 Intervention Design

Six behavioral interventions were developed, each tailored to address specific compliance barriers identified during the diagnostic phase. The interventions were informed by behavioral science principles, such as salience,

scarcity, social norms, and deterrence, and were designed to leverage the unique psychological and operational characteristics of each persona.

• Scarcity Messaging

Objective: Address procrastination by creating a sense of urgency.

Mechanism: Taxpayers received reminders emphasizing the limited time remaining before the filing deadline. For example: "*Only three days left to file your VAT return. Don't miss the deadline!*"

Behavioral principle: Scarcity has been shown to increase the perceived value of timely action, disrupting complacency and prompting immediate responses (Goldstein et al., 2008).

• Flexible Payment Options

Objective: Reduce financial concerns that may delay filing.

Mechanism: Messages highlighted the availability of installment plans to alleviate perceived cash flow constraints. For example: "*File your VAT now and spread payments over time with our flexible installment plans.*"

Behavioral principle: Providing actionable, reassuring options reduces perceived financial barriers and increases the likelihood of compliance.

• Social Norm Messaging

Objective: Motivate late filers by emphasizing that the majority of taxpayers comply on time.

Mechanism: Reminders framed late filing as an outlier behavior, leveraging social norms to encourage alignment with the majority. For example: "*90% of taxpayers in your category filed on time last month. Join the majority and file today!*"

Behavioral principle: Social norm messaging has consistently demonstrated effectiveness in tax compliance, increasing payment rates by as much as 15 percentage points (Hallsworth et al., 2014).

• Simplification

Objective: Reduce perceived complexity of the filing process.

Mechanism: Taxpayers were provided with a simplified checklist detailing the steps for VAT filing. For example: "*Filing your VAT is as simple as following these three steps: 1) Gather your documents, 2) Log into your account, 3) Submit your return.*"

Behavioral principle: Simplification reduces cognitive overload, making tasks appear more manageable and increasing the likelihood of action (Thaler et al., 2008).

• Deterrence for Bundlers

Objective: Disrupt consistent bundling by highlighting financial and legal consequences.

Mechanism: Messages emphasized the penalties and risks associated with bundling multiple filings. For example: "*Delaying filings could result in financial penalties and additional scrutiny. File each return on time to avoid unnecessary costs.*"

Behavioral principle: Deterrence messaging raises the perceived cost of non-compliance, encouraging proactive behavior (Pomeranz, 2015).

• Deterrence for Patterned Filers

Objective: Address consistent late filing patterns by emphasizing risks of repeated non-compliance.

Mechanism: Taxpayers received reminders highlighting the cumulative consequences of consistent late filing. For example: "*Consistently late filings may lead to penalties and additional regulatory oversight. Break the pattern — file on time today.*"

Behavioral principle: Highlighting cumulative risks disrupts entrenched habits, promoting sustained behavior change.

4.2 Outcome Measures

The evaluation framework was designed to capture both immediate and sustained impacts of the interventions. Metrics were selected to provide a comprehensive understanding of the interventions' effectiveness across different taxpayer personas.

4.2.1 Primary outcome

On-time filing rates were measured as the percentage of taxpayers filing their VAT returns on or before the deadline. Incremental impacts were calculated by comparing on-time filing rates between treatment and control groups.

4.2.2 Secondary outcomes

• Sustained compliance:

➢ Examine filing behavior over subsequent periods to assess whether the interventions led to long-term behavior change.

➢ Example metric: percentage of taxpayers maintaining on-time filing behavior in the quarters following the intervention.

• **Persona-specific impacts**:

➢ Evaluate the differential effectiveness of interventions across the three personas (bundlers, patterned filers, and irregular filers).

➢ Example metric: variance in incremental impact among personas receiving the same intervention.

5. Results

The findings of the behavioral interventions implemented by the ZATCA to improve on-time VAT filing rates are presented in this section. The analysis focuses on the incremental impacts of each intervention, their effectiveness across different taxpayer personas, and the broader implications for compliance improvement.

5.1 Summary of Results

The six behavioral interventions demonstrated varying levels of effectiveness, with incremental improvement in on-time filing rates ranging from 3 to 15 percentage points. These interventions targeted specific behavioral drivers across distinct taxpayer personas, leading to measurable impacts in most cases. Scarcity messaging emerged as the most effective, increasing on-time filing rates by 15 percentage points among irregular filers, while deterrence messaging for patterned filers resulted in an 8-percentage-point increase. Flexible payment options also proved effective across all personas, indicating financial constraints as a common compliance barrier. However, simplification had minimal impact, suggesting that complexity was not the primary obstacle to timely filing.

5.2 Detailed Outcomes

Each intervention's effectiveness is outlined below, highlighting its impact, underlying behavioral mechanisms, and key takeaways.

5.2.1 Scarcity messaging

This intervention, aimed at irregular filers, leveraged urgency by emphasizing the limited time remaining before the filing deadline. The treatment group saw a 70% on-time filing rate, compared with 55% in the control group, resulting in a 15-percentage-point increase. By applying scarcity principles, this approach effectively disrupted procrastination and motivated immediate action. These results align with previous research demonstrating that time-sensitive messaging enhances decision-making efficiency (Goldstein et al., 2008).

5.2.2 Flexible payment options

By addressing financial concerns and promoting installment plans, this intervention increased on-time filing rates to 61% in the treatment group, compared with 54% in the control group, yielding a 7-percentage-point improvement. Financial constraints were a recurring barrier across all personas, and this approach effectively alleviated perceived cash flow limitation. Behavioral research suggests that reducing financial stress through structured payment options enhances compliance rates (Thaler et al., 2008).

5.2.3 Social norm messaging

This intervention framed late filing as an outlier behavior, encouraging taxpayers to align with the majority who comply on time. The treatment group achieved a 53% on-time filing rate, slightly above the 50% in the control group, leading to a 3-percentage-point increase. While the impact was relatively modest, this approach reinforces the power of social norms in influencing behavior (Hallsworth et al., 2014). However, repeated messaging may be necessary to sustain long-term improvement.

5.2.4 Simplification

By providing taxpayers with a step-by-step checklist for VAT filing, this intervention aimed to reduce cognitive overload and make the process more manageable. However, the impact was negligible, with both treatment and control groups reporting nearly identical filing rates (51% vs. 50%). This suggests that simplification alone does not address the core compliance barriers, highlighting the need for motivational and financial interventions alongside process improvements.

5.2.5 Deterrence for bundlers

Bundlers — taxpayers who habitually group multiple filings — were targeted with messaging that emphasized financial penalties

and regulatory scrutiny. This approach resulted in a 4-percentage-point improvement, increasing the on-time filing rate from 43% to 47% in the treatment group. While deterrence strategies can be effective, their impact is often moderate compared with interventions that address psychological or financial barriers (Pomeranz, 2015).

5.2.6 Deterrence for patterned filers

For taxpayers with consistent late-filing habits, deterrence messaging highlighted the cumulative risks of repeated non-compliance. The intervention increased on-time filing rates from 67% in the control group to 75% in the treatment group, achieving an 8-percentage-point improvement. By disrupting entrenched behaviors and emphasizing long-term consequences, this approach proved highly effective in shifting compliance patterns.

5.3 Comparative Insights

Several key observations emerge from these results:

1) Urgency as a driver: Scarcity messaging had the most substantial impact, underscoring the effectiveness of time-sensitive communication in addressing procrastination, particularly among irregular filers.

2) Financial barriers matter: The success of flexible payment options across all personas highlights the significant role of financial constraints in compliance decisions.

3) Persona-specific effectiveness: Deterrence messaging achieved notable success among bundlers and patterned filers, reinforcing the importance of tailoring interventions to distinct taxpayers' behaviors.

4) Simplification is not a standalone solution: The lack of impact from simplification suggests that motivational and awareness barriers outweigh process complexity in this context.

The findings confirm that behavioral interventions can effectively improve VAT compliance when tailored to specific taxpayer personas and behavioral drivers. The most significant improvements were observed in interventions leveraging urgency and deterrence, emphasizing the value of segmentation and evidence-based intervention design. These insights offer a strategic foundation for further refining tax compliance initiatives and optimizing taxpayers' engagement through targeted behavioral interventions.

5.4 Discussion

The effectiveness of each intervention demonstrates the transformative potential of behavioral interventions in addressing non-compliance with VAT filing deadlines. By leveraging behavioral insights tailored to specific taxpayer personas, ZATCA achieved measurable improvement in on-time filing rates. The following discussion synthesizes the key findings, evaluates their implications through the lens of behavioral science, and explores the broader lessons for policy design and implementation.

5.4.1 Persona-specific impacts

The segmentation of taxpayers into personas — bundlers, patterned filers, and irregular filers — was instrumental in the success of the interventions. By tailoring behavioral nudges to the unique compliance barriers of each persona, ZATCA effectively addressed the diverse drivers of non-compliance.

5.4.2 Scarcity messaging for irregular filers

The most impactful intervention (15-percentage-point increase) highlighted the importance of urgency in driving compliance. Irregular filers, who often procrastinate due to low perceived urgency, responded strongly to scarcity-based reminders. This aligns with evidence showing that creating urgency disrupts inertia and motivates immediate action (Goldstein et al., 2008).

5.4.3 Deterrence messaging for bundlers and patterned filers

Interventions emphasizing financial and legal risks successfully disrupted consistent non-compliance among bundlers and patterned filers. The effectiveness of deterrence-based nudges mirrors findings from studies in Chile, where highlighting audit risks significantly improved VAT compliance (Pomeranz, 2015).

5.4.4 Social norm messaging for irregular filers

While moderately effective (3-percent-

age-point increase), this intervention demonstrated the potential of leveraging peer behavior to influence compliance. The relatively small impact suggests that repeated and reinforced messaging may be necessary to sustain behavior change, as observed in similar interventions in the UK (Hallsworth et al., 2014).

6. The Limitations of Simplification in VAT Compliance Interventions

The simplification intervention, which provided taxpayers with a checklist of VAT filing steps, did not yield significant improvement in compliance. This outcome suggests that motivational and awareness barriers play a larger role in non-compliance than capability deficits. While simplification is widely recognized as an effective strategy for reducing cognitive overload (Thaler et al., 2008), its limited impact in this case highlights the need for a deeper understanding of the behavioral drivers influencing taxpayers' decisions.

One possible explanation for the ineffectiveness of simplification is that many taxpayers already understand the filing process but fail to act due to a lack of urgency or motivation. In such cases, interventions that create a sense of urgency — such as scarcity messaging — or emphasize consequences, like deterrence messaging, may be more effective in prompting action.

From a policy perspective, these findings indicate that simplification alone may not be sufficient to address VAT non-compliance when motivational barriers are the primary obstacle. Future interventions should consider integrating simplification with other behavioral nudges to enhance effectiveness. For instance, pairing checklists with reminders that emphasize deadlines, or potential penalties could reinforce the need for timely action. This approach aligns with broader behavioral insights, suggesting that a combination of interventions is often more impactful than a single strategy.

7. Leveraging Behavioral Nudges for Long-Term Change

Several interventions have shown promise in fostering sustained behavior change, highlighting the potential of behavioral nudges to drive long-term compliance.

• **Deterrence for Patterned Filers**: This intervention not only resulted in immediate improvement but also demonstrated the possibility to disrupt entrenched habits, encouraging consistent compliance over time.

• **Scarcity Messaging**: By instilling a sense of urgency, this intervention aimed to create lasting shifts in the behavior of irregular filers, reducing future delays.

These findings are consistent with behavioral science research, which suggests that well-designed nudges can lead to the adaptation of behaviors, with initial changes becoming embedded in the long term (Thaler et al., 2008; Hallsworth et al., 2014).

8. Broader Lessons for Policy: Enhancing Compliance Through Behavioral Science

Key insights for policymakers aiming to optimize tax services and streamline tax compliance through behavioral interventions are presented below:

• **Segmentation and Tailoring**: The success of persona-specific interventions emphasizes the importance of segmentation in behavioral science. Generic approaches often fail to address the distinct challenges faced by different taxpayers' groups, while tailored nudges significantly improve impact.

• **Combining Nudges**: Given that behavioral drivers are often interconnected, combining multiple nudges can enhance effectiveness. For instance, integrating social norm messaging with scarcity or deterrence tactics can address various barriers simultaneously and boost compliance rates.

• **Cost-Effectiveness**: Behavioral interventions present a cost-effective alternative to traditional enforcement methods, such as audits and penalties. By promoting voluntary compliance, these nudges reduce administrative burdens and improve stakeholder trust in the regulatory system.

• **Cultural and Contextual Relevance**: The interventions' success underscores the im-

portance of adapting behavioral principles to fit the cultural and operational context. Messaging that aligns with local norms and values is more likely to generate meaningful behavioral changes.

9. Conclusion

This article demonstrates the power of behavioral science in improving VAT compliance, highlighting the success of tailored interventions in addressing the unique drivers of taxpayers' behavior. ZATCA's targeted approaches resulted in significant reductions in late filings, underscoring the importance of segmentation, urgency creation, and deterrence in designing effective compliance strategies.

• **Long-Term Impact**: Future research should explore the sustainability of these interventions, investigating whether behavioral changes persist over time or require periodic reinforcement.

• **Cross-Sector Applications**: The principles of behavioral science used here could be applied to other sectors, such as corporate governance, environmental compliance, and licensing.

• **Enhanced Personalization**: Leveraging advancements in digital communication and data analytics can enable even more dynamic and real-time adaptive interventions.

ZATCA's success exemplifies the transformative potential of behavioral science in regulatory compliance. By addressing behavioral barriers with precision and empathy, these interventions foster voluntary compliance, leading to a more efficient, equitable, and collaborative regulatory environment. This is a replicable model for integrating behavioral science into policy design and implementation, offering a valuable resource for governments worldwide facing similar compliance challenges.

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Tax Competitiveness: A Swiss Perspective*

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Abstract: Given its modest domestic market and limited natural resources, Switzerland depends on competitive conditions for its economy to flourish. Political stability, efficient infrastructure, legal certainty, and sound public finances ensure that Switzerland can compete successfully as a business location. Currently, the OECD minimum taxation for large multinationals poses a particular challenge for Switzerland.

Keywords: Tax competitiveness; Swiss economic policy; OECD/G20 minimum tax; Multinational companies

1. Background

With a population of around 9 million, Switzerland has a domestic market of modest size. The country also has few natural resources and no access to the sea. To compensate for these natural disadvantages, Switzerland relies heavily on offering competitive economic conditions, particularly for multinational companies and for highly skilled workers.

Consequently, Swiss economic policy has traditionally aimed to facilitate cross-border trade to provide the export-oriented Swiss economy with optimal conditions. Switzerland has constantly been striving to be able to prevail in the intense international competition between business locations.

There is also competition within Switzerland. The cantons (subordinate member states) have a high degree of autonomy and responsibility, especially in fiscal matters. In particular, they are free to set their tax rates. As a counterweight to tax competition resulting from this cantonal autonomy, there is a national financial equalization system as a solidarity-based balancing mechanism between the cantons. Less prosperous cantons, e.g. in mountainous areas, receive funds from financially stronger cantons and from the

* This article reflects the personal opinion of the author.

federal government. The combination of tax competition and fiscal equalization has traditionally been well received by the Swiss population.

2. Switzerland's Competitive Edge

According to the World Competitiveness Ranking by the International Institute for Management Development (IMD)[1], Switzerland was the second most competitive country out of 67 surveyed in 2024. It ranked first in the categories of "Government Efficiency" and "Infrastructure". Switzerland also ranked in the top three in previous years.

According to the BAK Taxation Index[2], Swiss cantons achieved an excellent result in international comparison in 2024 in terms of corporate taxation. The leading Swiss cantons are in some cases more attractive than Ireland, Singapore and Hong Kong SAR, China. Even the Swiss canton with the highest tax burden is well ahead of major competing locations such as London, Vienna, Milan, Munich and Paris. The Swiss cantons also perform very well in terms of taxes for employees. The leading cantons are right up there with the top group consisting of Singapore and Hong Kong SAR, China. Even the canton with the highest tax burden is still below the international average. In particular, the tax burden in Switzerland is low compared with competing locations in Western Europe.

3. What Is the Secret Behind Switzerland's Success?

As the IMD analysis confirms, a variety of elements contribute to a country's competitiveness. In addition to the factors already mentioned, Switzerland also benefits from a high degree of political stability and liberal labor laws.

The importance of taxes for a country's attractiveness as a business location can vary greatly. For highly mobile activities, taxes can be crucial, but for location-bound activities they play a marginal role.

Switzerland offers significant tax advantages for innovative companies. Moderate corporate income tax rates are complemented by tax incentives for research and development. At the cantonal level, income from patents and comparable rights is taxed at a lower rate if the company has developed these rights itself. In addition, companies in some cantons can claim an increased deduction for research and development activities.

Since a comprehensive tax reform that took effect in 2020, Swiss corporate tax law has been fully compliant with OECD standards and is highly accepted internationally. Switzerland also has a dense network of bilateral double taxation agreements, which in many cases provide for no or low withholding taxes for companies on interest, dividends and royalty payments.

Soft factors also play an important role in tax competitiveness. The business community depends on legal certainty to develop their activities optimally. In this respect, Switzerland offers a significant advantage with a well-established ruling practice in taxation. For example, a company can submit a planned restructuring to the tax authorities in advance. The tax authorities review the facts and provide a legal opinion within a reasonable period. This opinion is binding and creates legal certainty. This encourages taxpayers to disclose complex and financially significant transactions to the tax authorities on their own initiative. In many cases, the tax authorities thus become aware of potential fiscal risks at an early stage and can ensure that taxes are levied correctly. The ruling system thus offers an eminent advantage for both taxpayers and tax authorities.

1 IMD (2024). *World Competitiveness Ranking*, https://www.imd.org/centers/wcc/world-competitiveness-center/rankings/world-competitiveness-ranking/rankings/wcr-rankings/#_tab_Rank.

2 BAK Economics (2024). *BAK Taxation Index*, https://baktaxation.bak-economics.com/uebersicht; the Index considers the statutory rates for all relevant taxes at all levels of government, the interaction between the various taxes, and the most important rules for determining the tax bases. The result is the effective tax liability of a company and a highly skilled employee in the Swiss cantons and in their main international competitor locations.

In addition to legal certainty, Switzerland's political system guarantees a high degree of planning security. The national government consists of a broad coalition of several political parties, the composition of which has remained largely unchanged in recent decades. Legislative changes are subject to public consultations and take several years from launch to implementation. Retroactive changes to laws are taboo. In addition, the debt levels of the federal and cantonal budgets are low by international standards, and there is no general trend toward tax increases.

4. The Challenge of Global Minimum Taxation

The OECD/G20 minimum tax posed a considerable challenge for Switzerland. The project aims to limit tax competition between jurisdictions. At the same time, the new rules lead to a significant complication of tax law, high enforcement costs for companies and legal uncertainties. We estimate that around 2,000 to 3,000 multinational groups with parent or subsidiary companies in Switzerland are affected by the OECD/G20 minimum tax. These groups are important employers and account for a considerable portion of the corporate income tax revenue of the confederation and the cantons.

The Swiss government and parliament dealt with the project in great detail. They came to the conclusion that it is in Switzerland's economic and fiscal interest to adopt the OECD rules into national law. The main reason for this approach was the decision of the EU member states to adopt the minimum tax. This gave EU member states the option of taxing their multinational groups at a higher rate if their subsidiaries in Switzerland did not reach the minimum tax. Switzerland was therefore unable to prevent higher taxation for large multinational groups operating in Switzerland. Implementing the framework of the minimum tax in Switzerland has the advantage that Switzerland can collect these additional taxes itself. At the same time, the additional tax proceedings in Switzerland offer Swiss-based companies a maximum of legal certainty under the given circumstances. The Swiss economy has actively supported the implementation of the OECD/G20 project.

Switzerland has incorporated the OECD/G20 framework into its domestic law by means of a global reference in order to avoid any discrepancies. The OECD has also deemed the Swiss domestic top-up tax to be "qualified"[3], which means that Swiss-based companies in scope of the OECD/G20 minimum tax are protected as far as possible from additional investigations by foreign tax authorities.

5. Outlook

International competition between jurisdictions will continue. For large multinational companies, corporate income tax will tend to become less important as a location factor, while other conditions will become more important.

Since the OECD considers subsidies to be compatible with the minimum tax, direct government payments gain an advantage over traditional tax deductions. Switzerland has so far been reluctant to grant subsidies in its location policy. However, the changed conditions at the international level require to revisit this approach.

It is a cause for concern that OECD/G20 minimum tax contains serious inequalities. For example, shipping activities are excluded from the scope of application without objective reason, because numerous major countries have a preferential tax regime for these activities. Furthermore, with the so-called UTPR Safe Harbor, the OECD has introduced a temporary regulation that unfairly favors countries with

3 OECD (2025). *Tax Challenges Arising from the Digitalisation of the Economy — Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), Central Record of Legislation with Transitional Qualified Status*, https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/administrative-guidance-globe-rules-pillar-two-central-record-legislation-transitional-qualified-status.pdf.

a high nominal tax rate or groups from these countries, respectively. These groups are protected in their home country from higher taxation imposed by other countries, even if their effective tax burden is below the minimum taxation. Should the OECD perpetuate this safe harbor or even introduce additional rules that violate the principle of equal treatment, this could call into question the future of the whole project. Implementing countries would suffer a competitive disadvantage compared with non-implementing countries, and Switzerland would also have to consider whether implementing the rules continues to be in its best interest.

Regardless of the future of the OECD/G20 minimum tax, international competition will continue. In Europe in particular, many countries are in need of additional tax revenues. Thanks to its robust political, economic and fiscal fundamentals, Switzerland is well equipped for the future. It has repeatedly demonstrated in the past that it can maintain its competitiveness even when international conditions change.

Switzerland will also continue to actively engage in tax policy work in international organizations. It is to be hoped that this work will once again focus more strongly on the core tax policy question: how can a tax system be designed to achieve its fiscal goal while at the same time sparing individuals and companies as much as possible? Countries may be competitors when it comes to an individual taxpayer's decision on location. At the same time, however, they are also mutual export markets and suppliers of imports. A flourishing economy in one country is therefore also advantageous for others.

True to the original motto of the OECD: "Better policies for better lives"!

Tax Administration 3.0 and Beyond: An Analysis of Uganda's Digital Transformation Journey and Lessons for Improving Taxpayer Service in the 21st Century

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Abstract: Uganda Revenue Authority (URA) has gone through 3 phases of tax administration transformation, namely: Tax Administration 1.0, Tax Administration 2.0, and currently Tax Administration 3.0. In each of the phases there are specific innovations that are important for improving the tax environment, with each subsequent phase addressing the limitations and challenges that emerged in the previous phase. This article analyzes URA's digital transformation journey so as to demonstrate its impact on the tax environment. It further examines specific potentialities inherent in the digital transformation journey and explores strategies to effectively harness these potentials. The article recommends that the digital administration transformation is vital for effective taxpayer service delivery. It is noted that the introduction of Tax Administration 3.0 is a positive step toward enhancing tax administration systems in different countries. Tax authorities should conduct a thorough analysis of their respective tax systems and formulate tailored strategies aimed at transforming tax administration to meet emerging needs of taxpayers.

Keywords: Tax administration; Digital transformation; Taxpayer service

1. Introduction

Tax environment forms part of the business environment, and a good business environment plays an essential role in the development of enterprises.[1] In order to improve the tax environment and enhance taxpayer service, tax administrations have to embrace technological innovations in line with various global best practices. In fact, the current OECD international standard known as Tax Administration 3.0 focuses on the digital transformation of tax administration, thereby underpinning the importance of technology in ensuring an efficient tax administration regime.[2] This follows from Tax Administration 2.0 sometimes referred to as "e-administration" which not only involves the use of digital data and analytical tools by tax administrations, but includes enhancing collaboration with other government sectors, the private sector and other countries, as taxpayers and the entire economy become increasingly digitalized.[3] And the initial phase, namely Tax Administration 1.0, can be characterized as largely paper-based with many manual and siloed processes.[4] This article focuses on how technology can be used to enhance taxpayer experience by taking lessons from Uganda.

2. Digital Transformation of Uganda Revenue Authority (URA)

Digital transformation refers to the integration of technology into the various aspects of tax administrations' operations. From the inception of the URA, since 1991, the organization has moved through several Information and Communication Technology (ICT) deployment phases in order to modernize its tax administration.

2.1 Phase 1: Tax Administration 1.0 (Manual Phase)

OECD notes that Tax Administration 1.0 is characterized by a paper-based system with siloed processes, and adopts a tax administration-centred view on the operation of the tax system.[5]

The technology in this phase is:

- Forms driven (electronic & paper);
- Periodic, historical, and aggregated data;
- Manual, time-consuming and expensive;
- Designed for retrospective risk treatment; and
- Disconnected ecosystems.[6]

In 2009, URA transitioned to digitization, moving from analog to digital forms. This marked a shift from paper-based environment involving manual tools for tax registration, filing, payments and reporting, to basic stand-alone systems and databases which stored and managed taxpayer data.

2.2 Phase 2: Tax Administration 2.0 (Digitization Phase)

Under Tax Administration 2.0, a taxpayer-centric view has increasingly been adopted. New technology tools have been developed.

1 Christopher T., Benson T., Metropolitan International University Research Repository Extension, et al. (2024). *Adoption of Digital Revolution in Government Ministries, Departments, and Agencies (MDAs) In Uganda; Reflection on Uganda Revenue Authority Digital Strategy Integration Approach Towards Enhanced Tax Revenue in Post Covid-19 Pandemic,* https://www.researchgate.net/publication/380909270_Adoption_of_Digital_Revolution_in_Government_Ministries_Departments_and_Agencies_MDAs_In_Uganda_Reflection_on_Uganda_Revenue_Authority_Digital_Strategy_Integration_Approach_towards_Enhanced_Tax_Revenu.

2 OECD (2020). *Tax Administration 3.0: The Digital Transformation of Tax Administration*, https://doi.org/10.1787/ca274cc5-en.

3 *Ibid.*

4 *Ibid.*

5 Supra note 2, p.8. See also: Asia Development Bank (2022). *Launching a Digital Tax Administration Transformation What You Need to Know*, https://www.adb.org/sites/default/files/publication/792586/digital-tax-administration-transformation.pdf.

6 Supra note 2, p.8.

There have been significant increases in digital data sources to support the growth of e-administration. An expanding suite of e-services has been introduced. Better collaboration has been achieved within the tax administration and with some other government sectors. There has also been improved targeting of resources.[7]

URA entered the phase of Tax Administration 2.0 in 2009. This initiative resulted in the utilization of digital technologies and data to transform URA's operations. During this phase, URA launched the flagship eTax Solution, the Automated System for Customs Data (ASYCUDA World)[8], Enterprise Resource Planning (ERP), the Electronic Fiscal Receipting and Invoicing Solution (EFRIS), the Digital Tracking Solution (DTS), integration with Government Ministries, Departments and Agencies (MDAs), data exchange initiatives, and so on.

The following initiatives by URA can be highlighted in the phase of Tax Administration 2.0.

2.2.1 eTax

eTax is a name given to an Integrated Tax Administration System that provides online services to taxpayers on a 24/7 basis. eTax enables taxpayers to lodge their applications online through the web portal, from anywhere on the globe as long as connected to the internet. Upon uploading the application via the web portal, the system generates an e-acknowledgement receipt. The application will then be processed; the applicant will be contacted if there are any queries, interviews or inspections required. The applicant could search the status of his/her application on the system using a search code indicated on the e-acknowledgement receipt. If the application is approved after the process, the applicant will be issued a Tax Identification Number (TIN) with minimum details displayed on the Certificate of Registration. If the application is rejected, the applicant (taxpayer) will be issued a rejection notice stating the reason(s) for the rejection. Upon receiving the TIN, the taxpayer can log onto the web portal and create their own account for any further transactions. Some benefits of e-registration include a streamlined and time-saving process, as well as the convenience of completing application via the web portal. Besides registration, the taxpayer will be able to amend their details with URA in case of any changes. Taxpayers will always receive feedback on the application if accurate email addresses and telephone numbers (of the taxpayers) are indicated in the application. Through the eTax system, taxpayers can make e-filings and e-payments.[9]

2.2.2 Electronic Fiscal Receipting and Invoicing Solution

Electronic Fiscal Receipting and Invoicing Solution (EFRIS) is an initiative under the Domestic Revenue Mobilisation Program that aims to address the tax administration challenges relating to business transactions and issuance of invoices.[10] It is a new intelligent business solution

7 Supra note 2, p.8. Also: Asia Development Bank (2022) *supra*.

8 The Automated System for Customs Data (ASYCUDA) is a computerized customs management system that covers most foreign trade procedures. It handles manifests and customs declarations, along with accounting, transit and suspense procedures. It also generates trade data that can be used for statistical economic analysis. The ASYCUDA software is developed by United Nations Conference on Trade and Development (UNCTAD). ASYCUDA uses international codes and standards developed by the International Organization for Standardization (ISO), World Customs Organization (WCO) and the United Nations. It can be configured to suit the national characteristics of individual customs regimes, national tariffs and legislation. ASYCUDA provides Electronic Data Interchange (EDI) between traders and customs using prevailing standards, such as XML. See: Asycuda.Org. *About ASYCUDA*, https://asycuda.org/en/about/#:~:text=The%20Automated%20System%20for%20Customs,used%20for%20statistical%20economic%20analysis.

9 *eTAX policy in Uganda by Gloria Mukiibi (Kampala) (n.d.)*, https://www.africa-uganda-business-travel-guide.com/etax-policy-in-uganda.html.

10 Uganda Revenue Authority (2024). *KAKASA — Electronic Fiscal Receipting and Invoicing Solution Issue 1 Vol.2 FY 2023-24*, https://ura.go.ug/wp-content/uploads/2024/02/EFRIS-BROCHURE-2023-24.pdf.

used to record business transactions and share the information with URA in real time. It involves the use of e-invoicing through the URA web portal and direct communication with business transaction systems (system to system connection), Electronic Fiscal Devices (EFDs) and Electronic Dispenser Controllers (EDCs) to generate and manage e-receipts and e-invoices. Once a transaction is initiated using any of the EFRIS' components, transaction details are automatically transmitted to URA in real time to generate e-receipts and e-invoices.[11]

2.2.3 The Digital Tracking Solution

The Digital Tracking Solution (DTS) is a platform for tracking and tracing that immediately sends production and importation data for specific types of products to both URA and Uganda National Bureau of Standards (UNBS).[12] DTS involves the stamping of products with a digital stamp for tax purposes (URA), and conformity stamps for safety standards certification (UNBS).[13] Digital Tax Stamps are markings applied to goods or their packaging and contain, security features and codes to prevent counterfeiting of goods and enable them to be tracked and traced.[14]

2.3 Phase 3: Tax Administration 3.0 (Digital Transformation Phase)

According to OECD, Tax Administration 3.0 has the following characteristics:

- Taxpayers' natural systems at the center;
- Tax administration and other government sectors adopt processes to work seamlessly with those systems;
- Tax administration simultaneously becomes more resilient and more agile, something that "tax just happening".[15]

This phase is characterised by technology that is data-driven and event-based, possessing detailed and real-time data while enabling validation and automation. It ensures assured data, facilitates interoperable ecosystems and promotes international cooperation.[16]

URA entered Tax Administration 3.0 in 2023.[17] The goal of this transformation is to create "A simplified tax experience, near you". URA hopes that this transformation will result in optimization of its operations, strategic direction, and value propositions. This optimization will be achieved through deep and coordinated shifts in tech culture, workforce deployments, and the use of advanced technologies. These technologies include big data analytics, machine learning (ML), and predictive artificial intelligence (AI). And the goal is to transform tax administration processes and build an integrated, cyber-secured tax ecosystem.

3. Keys for Successful Digital Transformation of Tax Administration

Summarizing the aforementioned experiences, transition from a manual, forms-driven phase of tax administration to one which is event-based and data-driven is highly feasible. This, however, requires the establishment of certain conditions at both domestic and international levels as outlined below.

3.1 At a Domestic Level

3.1.1 Developing a good strategy for Domestic Resource Mobilization (DRM) and Information Technology (IT)

Each phase of Uganda's digital transformation journey has been marked by a clear strat-

11 *Ibid*.

12 Uganda Revenue Authority (2022). *A Simplified Guide on Digital Tax Stamps (DTS) Vol 1, Issue 3 FY 2021-22*, https://ura.go.ug/wp-content/uploads/2024/06/A-Simplified-Guide-on-DTS-FY-2024-25.pdf.

13 *Ibid*.

14 *Ibid*.

15 Supra note 2, p.8. Also see: Asia Development Bank (2022) *supra*.

16 *Ibid*.

17 *Ibid*.

egy for Domestic Resource Mobilization and Information Technology. For instance, to better facilitate the transition into the Tax Administration 3.0 phase, on 13 October 2023, URA launched the *URA Digitalization and IT Strategy 2023/2024 - 2026/2027*, which aims to empower every tax officer to continuously identify, contribute to and achieve measurable initiatives, results and benefits for URA's digital transformation.[18]

3.1.2 Harnessing the power of innovation

Technology has been at the heart of all the innovations that have taken place. In fact, the goals of the tax administration of the future, namely, Tax Administration 3.0, build on the objectives of Tax Administration 1.0 but with improved technology. In this regard, along with the launch of the *URA Digitalization and IT Strategy 2023/2024 - 2026/2027*, URA also unveiled its latest flagship innovations and tax solutions to the public.[19] These include:

• **The New URA Tier III Data Center**: This has been termed the best state-of-the-art government data center nationwide.[20]

• **The Touchpoint**[21]: The Touchpoint is URA's integrated Online CRM tool for incident management, service provision and one-on-one communication with taxpayers.

• **The *285# URA USSD Channel**: It is designed to provide tax convenience services for all, especially the informal sector. This USSD code can be used for tax payment and TIN services.[22]

• **Brand-New URA Website**:[23] To enhance user experience and interface design, URA has created a brand-new website with various additional functionalities including the use of AI.

• **New Tax Accounting Module**:[24] To improve accuracy and arrears management, URA has introduced a new accounting module.

• **Tax Procedure Code 40D Waiver Implementation**:[25] It allows for the waiver of interest and penalties upon voluntary payment of principal tax outstanding as at 30 June 2023.

• **Webforms**:[26] Webforms, which include monthly VAT, Rental Income Tax, and Quarterly VAT for Non-Resident Service Providers, have been uploaded on the URA website with the aim of simplifying tax returns.

• **BWMIS**:[27] BWMIS is a Bonded Warehousing System to streamline cargo management.

18 We Are Tech Africa (2023). *Uganda Revenue Authority Unveils Digitization Strategy to Improve Resource Collection*, https://www.wearetech.africa/en/fils-uk/brief/brief-simple/uganda-revenue-authority-unveils-digitization-strategy-to-improve-resource-collection.

19 Real Muloodi News Network (n.d.). *Digital Transformation: URA Pioneers a Tech-Driven Revolution for Tax Compliance*, https://realmuloodi.co.ug/digital-transformation-ura-pioneers-a-tech-driven-revolution-for-tax-compliance/?amp=1.

20 The Taxman (2024). *URA Set to Launch a Data Centre*, https://thetaxman.ura.go.ug/?p=5181.

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22 David Okwii (2023). *URA Introduces USSD Code *285# for Tax Payments and TIN Services*, https://www.dignited.com/116957/ura-ussd-code-285-tax-payments-and-tin-services/.

23 The new URA website can be accessed at: www.ura.go.ug.

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26 The webforms can be accessed on the URA website at: www.ura.go.ug.

27 Business Focus (2022). *URA Starts System Monitoring Bonded Warehouse Operations Online, to Reduce Tax Leakages*, https://businessfocus.co.ug/ura-starts-system-monitoring-bonded-warehouse-operations-online-to-reduce-tax-leakages/.

3.2 At an International Level

3.2.1 Utilizing the avenue of international collaboration to address emerging challenges

The digital transformation journey presents an avenue for tax authorities to collaborate so as to come up with better ways to meet the taxpayer needs of the 21st century. One such collaboration is the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM), which is a non-profit official mechanism for tax administration cooperation amongst the jurisdictions that subscribe to the Belt and Road Initiative.[28] This initiative is operated on the basis of respecting the sovereignty and respective laws of all participating jurisdictions.[29] The BRITACOM aims to contribute to building a growth-friendly tax environment through cooperation and sharing of best practices in following rule of law, raising tax certainty, expediting tax dispute resolution, improving taxpayer service, and enhancing tax capacity building.[30]

3.2.2 Creation of interoperable ecosystems

Creation of interoperable ecosystem is very important for tax administration in the digital age. The European Committee for Interoperable Systems defines interoperability as a state where a computer program can communicate and exchange information with other computer programs, and all programs involved can use that information.[31] An area where cross-border interoperability can be very important is with regards to e-invoicing. A good step in this regard would be the development of a global e-invoicing interoperability framework since there is currently no known framework for cross-border interoperability globally. An e-invoice interoperability framework is a set of policies, standards and guidelines that enable the exchange of e-invoices, independent of the payment system, accounting system and ERP systems.[32] This provides an opportunity that can be harnessed by tax administrators in order to make tax administration more effective.

4. Conclusion

The 21st century presents unique challenges that require innovative approaches to tax administration. In this regard, the digital transformation of tax administration under Tax Administration 3.0 is a step in the right direction. This improves the tax environment and thereby leads to better taxpayer service. The lessons highlighted above

28 See: BRITACOM (n.d.). *Introduction to the BRITACOM*, https://www.britacom.org/jzgk/britacom/.

29 *Ibid*.

30 *Ibid*.

31 European Committee for Interoperable Systems (n.d.). *Interoperability and Open Standard*, https://www.ecis.eu/open-standards/.

32 The Business Payments Coalition e-Invoice Work Group (2019). *Overview of an e-Invoice Interoperability Framework*, https://businesspaymentscoalition.org/wp-content/uploads/20191031-bpc-overview.pdf.

can be used by any tax authority that is undertaking the digital transformation journey. It is however noted that a one-size-fits-all solution is not practical, therefore the paper recommends that in order for tax authorities to match up with their taxpayers' needs, they need to analyze their respective tax systems and come up with strategies aimed at transforming to address those emerging needs. These lessons can offer valuable insights to tax authorities intending to do this.

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Latin America and the Caribbean's Efforts to Promote Tax Compliance for Multinational Companies

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Abstract: This article explores the efforts of Latin America and the Caribbean (LAC) countries in addressing challenges related to international tax planning and compliance for multinational companies. It highlights the importance of corporate income tax (CIT) in the region, the adoption of OECD's BEPS Action Plan, and the evolution of transfer pricing (TP) regimes. The article also examines anti-abuse measures, the implementation of General Anti-Avoidance Rules (GAARs), and the complexities faced by tax administrations in a globalized and digitalized economy. While significant progress has been made, the article underscores the need for innovative reforms to enhance compliance, reduce disputes and strengthen enforcement on the side of the tax administrations.

Keywords: International taxation; Corporate income tax; Transfer pricing; General Anti-Avoidance Rules (GAARs); Base Erosion and Profit Shifting (BEPS); Exchange of Information (EOI); Harmful Tax Practices; Latin America and the Caribbean (LAC)

1. Introduction

The objective of this article is to review the experiences of Inter-American Center of Tax Administrations (CIAT) member countries in Latin America and the Caribbean (LAC) in the field of international tax planning control and to identify trends and best practices. LAC is a region that involves asymmetric sub-regions (e.g., English Caribbean, Central America, Andean Countries, etc.) and countries with unique characteristics (e.g., Brazil, Mexico, Panama, Guyana, Cuba, among others) that require special attention. Therefore, it is not easy to propose tax policies or administrative standards that fit all contexts. However, there are some common aspects, linked to abusive tax behaviors and tax treatment of multinational companies, on which regional recommendations could be formulated.

In this sense, in the second section of this article, some reflections are shared on the current context in which governments and in particular tax administrations

perform, the role of anti-abuse rules, and the challenges faced by tax administrations. In the third section, we provide information on the relevance of the corporate income tax (CIT) in LAC countries, a summary of the situation of LAC countries in relation to the adoption of the Organisation for Economic Co-operation and Development's (OECD's) recommendations proposed in the Base Erosion and Profit Shifting (BEPS) Action Plan, the transfer pricing (TP) regimes, and the general anti-avoidance rules (GAARs). For these topics, we also provide some reflections on trends, good practices, and opportunities. In the fourth section, we share some reflections on what has been presented throughout this article.

2. International Tax Planning, Tax Avoidance and Anti-Abuse Measures

According to the Royal Spanish Academy,[1] a company is an organizational unit engaged in industrial, mercantile or service-providing activities for profit. The last two words of this definition remind us that a company works to maximize its profits. Since taxation is a cost of doing business, it influences the competitiveness of companies and consequently their profits. Therefore, it is understandable that companies organize themselves in the most efficient and effective way to pay a fair amount of taxes, especially in such a competitive environment as the current one. Those of us who work in taxation field know that complexity surges when you start discussing what a "fair amount" would be according to tax rules. This is where the dilemma arises as there is a very thin line between the so-called "economy of choice" and "tax avoidance". In line with the aforementioned, Dr. Torres expresses in chapter 2 of the CIAT—GIZ—EUROsociAL Manual for the Control of International Tax Planning, *"…tax planning can have as its object, both an organization of lawful acts, elaborated in accordance with the law, and it can also include a programming of attitudes, either active or passive, for illicit purposes, with the intention of minimizing the tax burden"* (Torres, 2022).[2]

The above highlights the complexity that tax administrations face when qualifying the legitimacy of a taxpayer's conduct. In a global environment, this exercise becomes even more complex, due to the multiplicity of elements to be verified that may represent risks (e.g., divergence in tax rules of countries, opaque contractual figures, opaque corporate rates, complex financial instruments, etc.).

In the past, the control of international operations was associated with the needs or priorities of countries. Currently, because of the globalization process, the control of international operations is a priority for any country.

Globalization is a constantly evolving process. It has exponentially multiplied international operations, involving even smaller subjects. This process has changed the rules of the game and the way of doing business. Understanding it was the starting point to understand businesses and their behaviors for tax purposes.

In recent years, with the addition of new processes, the digitalization of the economy and a certain economic polarization could change the current rules. These changes impose new challenges on governments. Understanding these changes and the functioning of business in a changing context is one of the most critical aspects that governments face when reforming the tax system.

From the perspective of companies, the influence of the BEPS Action Plan and other international initiatives has led them to request increasingly sophisticated services, to avoid being caught by anti-abuse standards and to comply correctly with new information regimes. This situation increases the cost of tax planning and can lead to dilemmas about whether to take aggressive tax positions or comply voluntarily.

Given the afore-mentioned scenario, many tax administrations of LAC are making efforts to

1 https://www.rae.es.

2 CIAT (2022). *International Tax Planning, Manual for the Control of International Tax Planning*, https://www.ciat.org/2-international-tax-planning/?lang=en.

create high-level services for taxpayers. Attaining the objective, in an ideal scenario, would avoid the materialization of non-compliance risks, reduce tax compliance costs, increase tax compliance and avoid disputes, thus generating a better business climate. These objectives are critical in a context where the global minimum tax would neutralize tax benefits and change the level of competition between jurisdictions.

In this sense, when adopting anti-abuse packages, the strategy of states should be: to deter unwanted behaviors, to promote compliance, and to promote equity between taxpayers who have access to international tax planning and those who do not. These types of measures work best in a tax administration with a risk-based approach, which only applies these measures when a risk is identified and verified and a measure is the best action to address it.

3. Brief Analysis of the Situation of LAC in the Field of International Taxation

3.1 The Importance of Corporate Income Tax for LAC Countries

Historically, international taxation has focused mainly on direct taxes and in particular the CIT. This is evidenced by the advances in the field of Double Taxation Conventions (DTC), TP and most of the measures found in the BEPS Action Plan. Recent international discussions on indirect taxes have focused mainly on the commercialization of digital goods and services and certain frauds (e.g., "carousel").

Before addressing the situation of LAC countries in terms of international taxation, the following question should be asked: how relevant is the CIT in LAC? To answer this question,

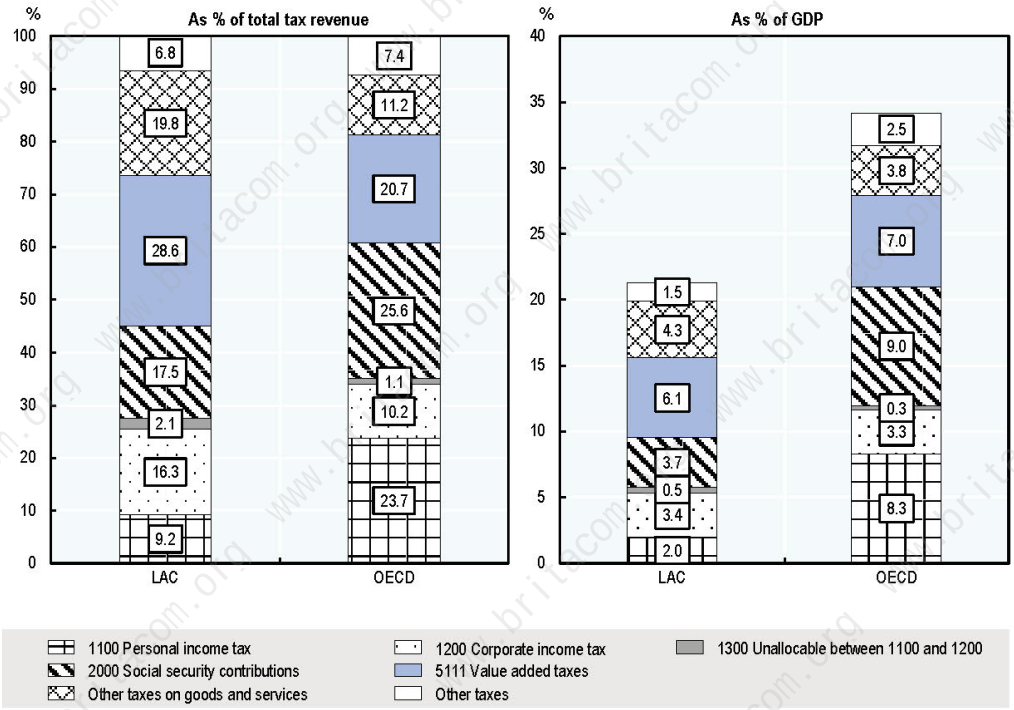

Figure 1. Average tax structure in the LAC and the OECD, 2021

Note: The year of comparison is 2021 as the 2022 tax structure for the OECD average is not available. The LAC average excludes Venezuela due to data issues. Ecuador is excluded from the LAC average for PIT and CIT revenues due to data quality issues. The OECD average represents the unweighted average of the 38 OECD member countries. Chile, Colombia, Costa Rica and Mexico are also part of the OECD (38).

Source: OECD Tax Statistics (database). *Revenue Statistics in Latin America and the Caribbean: Comparative Tables*, http://dx.doi.org/10.1787/data-00641-en.

one can look at Figure 1, which shows the tax structure of 27 LAC countries and 38 OECD member countries for the year 2021.

In the graph on the left, the CIT represents 16.3% of the total revenue of LAC countries and 10.2% of the revenue of OECD countries. The Personal Income Tax (PIT) represents 9.2% of the total revenue of the LAC countries and 23.7% of the revenue of OECD countries. Thus, the CIT has the greatest specific weight in the field of direct taxation for LAC countries.

If we concentrate on the graph on the right, the difference in the share of the CIT as a proportion of GDP is not significant between LAC and OECD countries, representing 3.4% and 3.3% respectively.

Figure 2 shows the evolution of the share of various taxes as a proportion of GDP between the years 2005 and 2022.

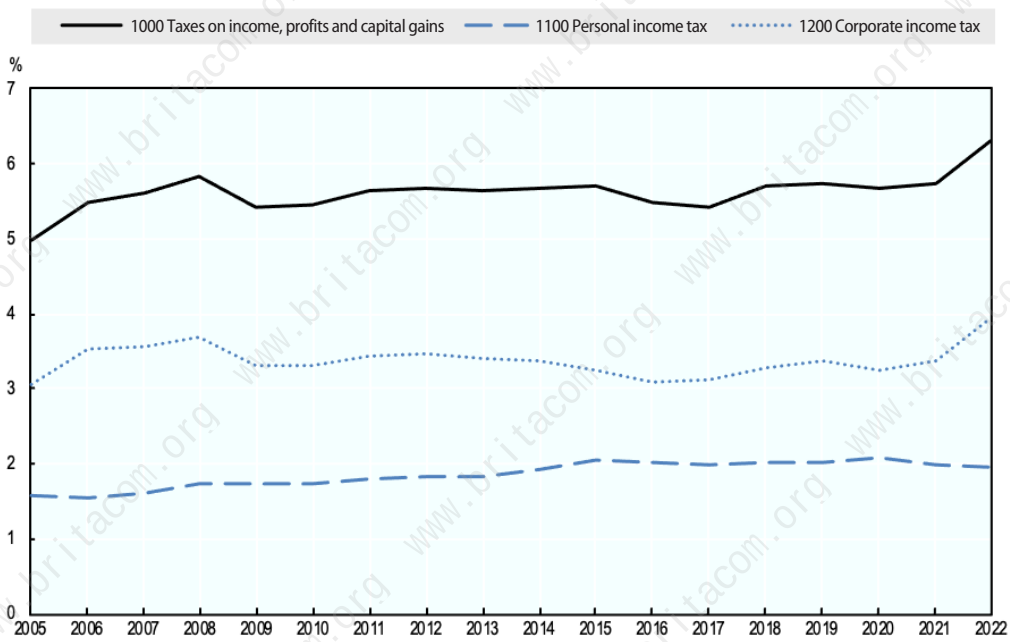

Figure 2. Revenue from taxes on income and profits, CIT and PIT in the LAC region, 2005-2022
Note: The LAC averages exclude Cuba (up to 2020) and Venezuela due to data issues, Ecwador is included in the LAC average for total income tax revenues but excluded from the LAC averages for PIT and CIT revenues as a percentage of GDP.
Source: OECD et al. (2024). *Revenue Statistics in Latin America and the Caribbean: Comparative Tables*, http:dx dol.org110.1787/data-00641-en.

We can see that the CIT has been much more volatile than the PIT, being dramatically affected by crises, commodity price fluctuations, pandemics and even economic growth cycles that occurred during the period under analysis. It can also be seen that the CIT has been more significant than the PIT in terms of revenue. In the field of collection efficiency, Table 1 provides valuable data (CIAT, 2024).

The tax collection efficiency ratio of the CIT is between 0.22 and 0.62, with an average of 0.42 and that the average inefficiency ranges between 0.11 and 0.47 for tax expenditures and non-compliance (X inefficiency) respectively.

Although there is a significant dispersion between the data from various countries in the sample, it can be stated that the potentiality of collecting this tax is extremely high for LAC. This is critical due to the specific weight that this tax has for the region.

For these reasons, and others that are not addressed in depth in this article (e.g., risks in-

Table 1: Components of potential corporate income tax collection

Country	Efficiency	Inefficiency Tax Expenditure	X Inefficiency
Argentina	0.28	0.04	0.68
Bolivia	0.41	0.11	0.48
Brazil	0.32	0.08	0.6
Chile	0.60	0.11	0.29
Colombia	0.43	0.08	0.49
Costa Rica	0.33	0.14	0.53
Ecuador	0.53	0.22	0.25
El Salvador	0.33	0.12	0.55
Honduras	0.29	0.22	0.49
Jamaica	0.41	0.02	0.57
Mexico	0.44	0.07	0.49
Nicaragua	0.59	0.12	0.29
Panama	0.22	0.18	0.60
Paraguay	0.58	0.05	0.37
Peru	0.34	0.01	0.65
Dominica	0.62	0.12	0.26
Uruguay	0.46	0.18	0.36
Average	0.42	0.11	0.47

Note: The "X Inefficiency" is a residual value, which is obtained after deducting the actual collection and tax expenditures to the potential collection. It presents a discrepancy component between the estimate of the taxable base and the true taxable base, and an effective inefficiency component that can be attributable to tax non-compliance.
Source: CIAT (2024). Collection Efficiency and Tax Gap in Latin America and the Caribbean: Value Added Tax and Corporate Income Tax. DT-02-2024.

herent to critical LAC business, international tax commitments, business climate, etc.), it is an opportunity for LAC countries to reduce the CIT gap, betting on strengthening measures to control abusive international tax planning and improving the relationship with multinational companies.

The following subsections present the efforts made by the LAC countries to meet the objective of reducing the afore-mentioned gap.

3.2 Evolution of the Adoption of Actions Inspired by the BEPS Action Plan by LAC Countries[3]

The vast majority of CIAT member countries in LAC are part of the BEPS Inclusive Framework (18 countries). Of these countries, only four (Mexico, Chile, Colombia and Costa Rica) are members of the OECD. The BEPS Action Plan establishes that four of its fifteen Actions are mandatory minimum standards:

3 BEPS monitoring data were used for this section. CIAT Data, CIAT, 2024.

➢ Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance;

➢ Action 6: Prevent treaty abuse;

➢ Action 13: Re-examine transfer pricing documentation; and

➢ Action 14: Make dispute resolution mechanisms more effective.

Precisely, its binding nature is reflected in the political will of countries in the sample; 90% adopted measures inspired by Action 5, 70% adopted measures inspired by Action 6, and 80% adopted measures inspired by Actions 13 and 14.

Figure 3 shows the number of countries that adopted BEPS recommendations, classified by Action, for the years 2021 to 2024.

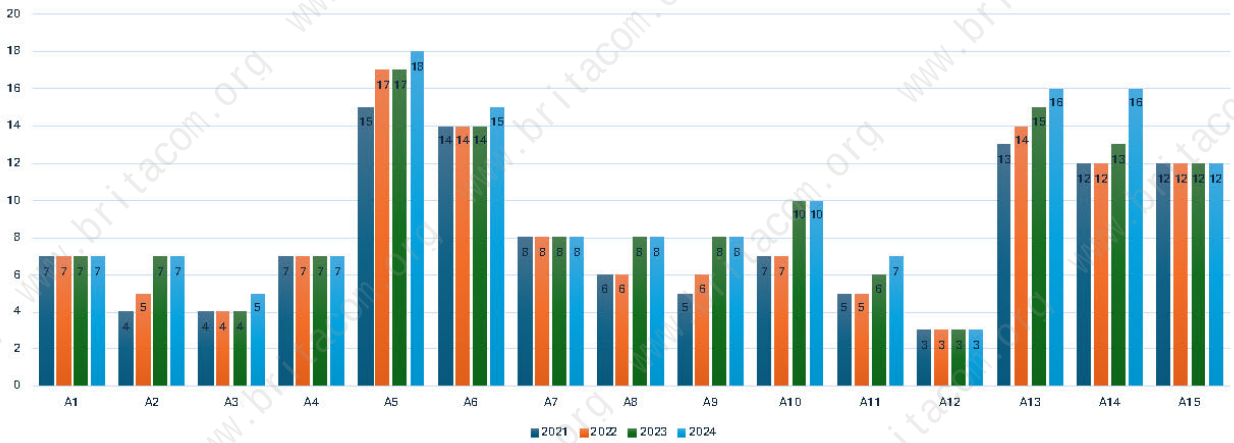

Figure 3. BEPS Actions adopted by 20 LAC countries (2021/2022/2023/2024)
Source: BEPS Monitoring, CIAT Data, CIAT, 2024.

the LAC countries in adopting optional recommendations from the BEPS Action Plan, which shows the genuine interest in controlling tax avoidance and evasion. Several of these measures are innovative for the region, which requires a greater effort at the practical level. For example, the rules on Controlled Foreign Corporations (CFCs), the measures to neutralize the effects of hybrid mechanisms and the measures for early disclosure of tax schemes. In the Caribbean sub-region, countries have been more conservative when it comes to implementing the non-mandatory Actions.

Compared with previous years, the adoption of Actions 2, 8, 9, 10, 13 and 14 evolved significantly in 2023 and 2024. The Actions that have grown the most are those related to TP and dispute resolution. This is no coincidence, since most of the countries in the sample have been allocating significant resources on TP in the last decades. However, the resolution of international tax disputes is a topic in which many LAC countries have recently been venturing, particularly because there are countries that do not have tax treaties, and most countries still have small treaty networks. Due to its importance, the LAC situation in terms of TP is treated in more detail in the following section.

It is important to highlight the interest of

Figure 4 shows the number of BEPS Actions implemented by LAC countries in years 2021 to 2024.

The countries that adopted the most actions are Mexico, Argentina, Costa Rica, Colombia and Chile. Except for Argentina, these countries are OECD members. Surely this situation may have influenced the level of implementation.

The countries that adopted the newest BEPS Action Plan recommendations in 2023 were Brazil and Paraguay. In the case of Brazil, the convergence of its TP standards with OECD guidelines set an important precedent that has

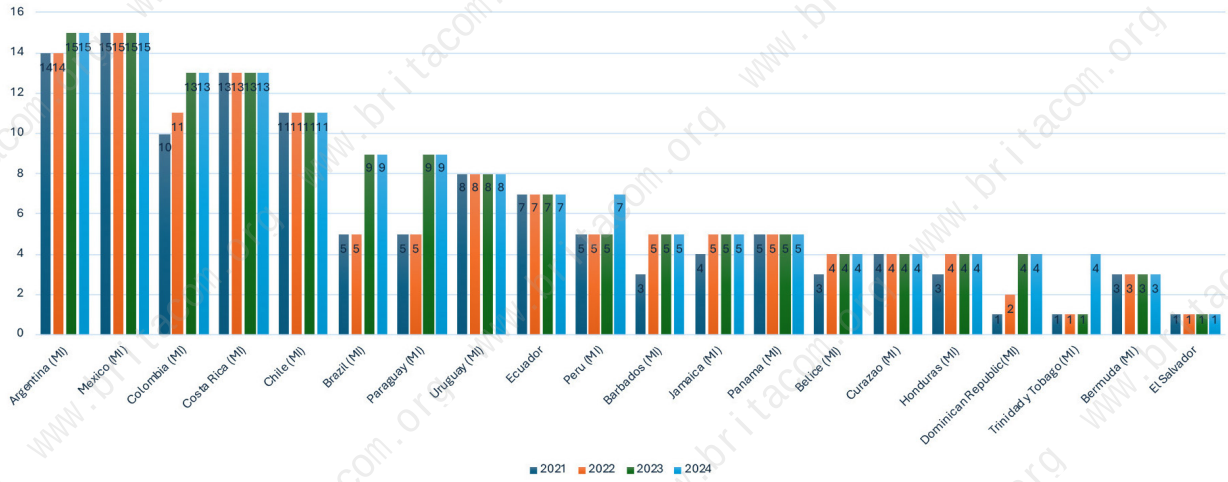

Figure 4. LAC jurisdictions that have adopted BEPS Actions (2021/2022/2023/2024)
Source: BEPS Monitoring, CIAT Data, CIAT, 2024.

surely motivated the adoption of additional measures.

Although Ecuador and El Salvador are not members of the BEPS Inclusive Framework, they also implemented BEPS actions. This indicates interest in the matter, especially on the part of Ecuador, which adopted several measures inspired by the BEPS Action Plan (Actions 1, 3, 4, 6, 8, 9 and 10). El Salvador adopted in 2021 paragraphs 1, 2 and 3 of Article 25 of the OECD Model Tax Convention on Income and on Capital 2017 (OECD Model), as part of Action 14 to make access to the mutual agreement procedure (MAP) more effective and effectively resolve international tax disputes.

BEPS Action 1 "Addressing the tax challenges of the digital economy" is currently one of the most innovative topics, which has generated the most debate at a global level. This action can be divided into two parts: first is the indirect taxes (VAT/GST) which aim to collect taxes originating from digital goods and services provided by subjects that do not have a physical presence in the country where they are marketed, and the second is the CIT part which addresses the taxation of large multinational companies at a global level.

Regarding the first part, 7 countries (Paraguay, Mexico, Ecuador, Costa Rica, Colombia, Chile and Argentina) allow companies to register, declare VAT and make payments even if they do not have a physical presence.

In Ecuador, Costa Rica, Colombia and Chile, when a company decides not to register, tax administrations in these countries may use payment methods to collect VAT (e.g., collection of VAT on credit card purchases). Paraguay is the only country in the sample that collects direct and indirect taxes using means of payment. In this area, CIAT, with the support of the Norwegian Cooperation (NORAD) and the German Cooperation (GIZ), developed a tool called "Digital Economy Compliance" (DEC),[4] which allows tax administrations to implement the recommendations of the "Digital VAT Toolkit for Latin America and the Caribbean". This tool was reviewed and validated by the OECD, which stated that it offers sufficient functionalities to address its recommendations and even includes additional functionalities.

Regarding the second part, in the scope of CIT, the OECD introduced in February 2024 into its Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations

4 https://www.ciat.org/the-dec-tool-digital-economy-compliance-tool-adds-new-functionalities/?lang=en.

(TPG) an Annex to Chapter IV called "simplified approach", which considers the recommendations of Amount B of Pillar One. This approach consists of a pre-determined remuneration for basic marketing and distribution activities, which seeks to simplify the application of TP methods for this type of related-party transactions. This measure is the only one issued by the OECD under Pillar One. It is optional and has not yet been adopted in LAC.

Pillar Two determines a minimum effective tax of 15%, applicable to companies with a consolidated revenue of more than 750 million euros globally. This tax is calculated based on GloBE, which is a methodology to harmonize the calculation of the taxable base, facilitating the calculation of the effective tax rate. This initiative proposes various mechanisms and is of optional application.

Table 2 and Figure 5 provide information about 13 LAC countries that have made efforts to understand or implement measures based on the Pillar Two proposals. The upper part shows a table with detailed data by stage and country, and the lower part shows a bar chart with the data aggregated and classified by stage.

Currently, most LAC countries are studying the issue or evaluating its impact in order to make a decision. Colombia adopted measures inspired by the Qualified Domestic Minimum Top-up Tax (QDMTT) and worked on the harmonization of incentives based on GloBE.

In this respect, some of the main concerns for countries are the uncertainty of the actions taken by their relevant commercial counterparts and the decisions taken by investors when their tax benefits are neutralized. Other concerns stem from the limited administrative capacity to manage the measures to be implemented, the high administration and compliance costs and the difficulty of aligning government priorities with international tax trends.

For the countries interested in implementing Pillar Two in the short term, the difficulty of finding a legislative opportunity is worrisome, since it is not possible to adopt it automatically (e.g., some countries can only propose reforms at the beginning of a governmental period).

Table 2: Stage of LAC countries to understand or implement Pillar Two

Stage	Argentina	Barbados	Brazil	Chile	Colombia	Costa Rica	Dominican Republic	Honduras	Mexico	Panama	Paraguay	Peru	Uruguay
Learning	1	1	1	1	1	1	1	1	1	1	1	1	1
Assesment of potential impact	1	1	1	1	1	1	1	1	1	1	1	1	1
Coordination of MoF-TA	1	1	1	1	1	1	1	1	1	1	No	1	1
QDMTT	No	No	No	No	1	No	No	No	No	No	No	No	No
IIR	No	No	No	No	No	No	No	No	No	No	No	No	No
STTR	No	No	No	No	No	No	No	No	No	No	No	No	No
UTPR	No	No	No	No	No	No	No	No	No	No	No	No	No
Other reforms	No	No	No	No	1	No	No	No	No	No	No	No	No
Align incentives with GloBE	No	No	No	No	1	No	No	No	No	No	No	No	No

Source: BEPS Monitoring, CIAT Data, CIAT, 2024

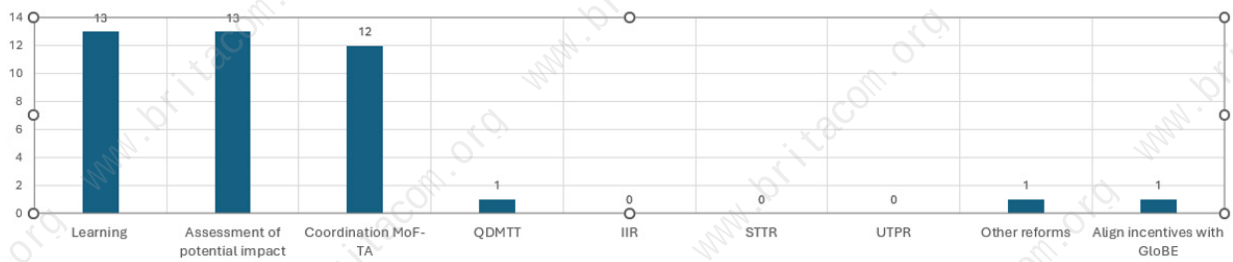

Figure 5. Data aggregated and classified by stage
Source: BEPS Monitoring, CIAT Data, CIAT, 2024.

3.3 The Evolution of Transfer Pricing Regimes in LAC[5]

The control of TP deserves a specific section, as it is the issue that has received the most attention in LAC. Currently, the vast majority of the LAC CIAT member countries have a TP regime. There are only a few countries that do not yet have such rules. Figure 6 shows the evolution of TP standards in LAC and confirms the aforementioned. The green line shows the year in which the TP standards were approved, the blue line shows the year in which they went into force and the orange line shows the year in which the first audit was conducted in each country.

The first control experience took place in Mexico in 1992. Mexico has made sustained progress in the field, and currently it is one of the LAC countries with the greatest resources and experience in TP. More than 60% of countries put their standards into effect in the second and third decades of the 21st century. If we consider that the controls are ex post (at least one year after the validation of the norm), it is possible to assert that the TP practice is still young in the region. In most countries, the first audits were conducted after 2012.

LAC TP regimes are generally aligned with the OECD's TPG. Almost all of the countries adopted the Arm's Length Principle (ALP) and the TPG's five recommended methods. Even the latest reforms implemented by the countries of the region reinforced this. For example, the most recent reforms have been related with topics found in the reports for BEPS Action Plans 8, 9 and 10, the latest convergence of Brazil's TP standards with the TPG, and the references to the TPG found as a source of inspiration or supplementary instrument in the face of gaps in TP standards (9 LAC countries).

Given this scenario, it could be asserted that there is a high level of harmonization and sufficient consistency between countries to meet two of the main objectives of a TP regime: (1) to ensure that it is taxed where value is generated and (2) to avoid international economic double taxation. However, if we evaluate the LAC standards in more detail, we find asymmetries. For example:

➢ Entities and transactions reached: In gen-

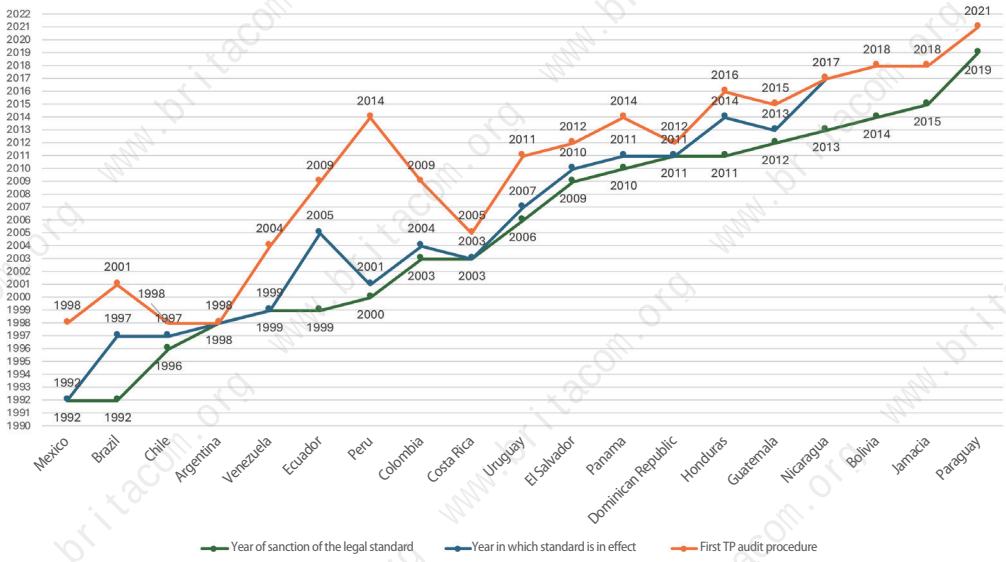

Figure 6. The evolution of TP regimes in LAC countries
Source: Transfer Pricing, CIAT Data, CIAT, 2024.

5 This section was prepared using data from the Database on transfer pricing rules and practices in Latin American and Caribbean countries. CIAT (2021). *Database on Transfer Pricing Rules and Practices in Latin American and Caribbean Countries*, https://www.ciat.org/transfer-pricing/?lang=en.

eral, the subjects reached are usually those who conduct transactions between related parties, those who conduct operations with subjects located in "tax havens" or preferential regimes and those who conduct operations with exempt subjects or who have access to a lower tax rate. In this area, asymmetries are presented in the additional criteria, used by a smaller proportion of countries, and thresholds based on transaction amounts and/or company assets. There are also differences on the territorial scope of the TP regime, since 67% of the LAC member countries from CIAT contemplate the application of the regime to domestic operations.

➢ Concept of related party: The criteria for being a related party for TP purposes is not interpreted in the same way by countries, for example:

• Thresholds: In order to establish a relationship, LAC countries consider equity participation thresholds ranging from 1% to more than 50%;

• Additional criteria: Some countries consider that there is a relationship for reasons of kinship, effective administration, proportion of transactions, contractual exclusivity, presumption of connection due to transactions with tax havens, etc. Even within some of the mentioned criteria, more divergences may arise. For example, the degree of kinship, the definition of a tax haven, etc.

These aspects have a strategic component for tax administrations by aligning the number of taxpayers obliged to comply with the TP regime with their management capacity.

The following are some additional examples of existing divergences in the TP regimes of LAC countries:

➢ The so-called "sixth method"[6]: For some countries it constitutes a specific anti-abuse measure and for others it is a way of applying the Comparable Uncontrolled Price (CUP) method or a method in itself. Additionally, significant changes are presented in its design (e.g., determination of prices, affected transactions, application criteria, etc.).

➢ Advanced Pricing Agreements (APA): These exist in 13 LAC countries, either in domestic and/or international standards. There are differences in procedures, especially in terms of deadlines, control powers and negotiation strategies.

➢ Safe Harbors: Few countries have safe harbors or even the possibility of implementing them (Mexico, Brazil, Ecuador, Honduras, and the Dominican Republic), while the design of those currently in place is diverse.

➢ Alternative methods: In some countries, a taxpayer and/or the tax administration may propose other alternative methods to those of the TPG, when appropriate. On the contrary, the tax administration of El Salvador, in its control processes, is subject to using a market price method like CUP, whose "comparable" must be from the same jurisdictions involved in the analyzed operation.

➢ Method selection: For this purpose, 5 countries use the hierarchy criterion based on a priority of methods, 12 use the criterion of the "best method rule" and 6 raise exceptions to the general rules mentioned above, mainly regarding the application of the sixth method when this has priority.

Nevertheless, at the practical level, the differences are even greater, and this has to do with the context of the countries, the level of maturity of the tax administration and/or the years of practice in the field. Some examples are given below.

➢ Databases: there are 6 LAC countries that do not use databases of any kind to apply their TP regime and only 7 countries have designed

6 In transfer pricing, the "Sixth Method" is an approach for pricing raw materials and commodity transactions which was created in Argentina and later adopted by other Latin American and African countries. It determines the arm's length price based on publicly quoted prices from commodity exchanges, usually focusing on the agreed-upon transaction date to ensure transparency and prevent profit shifting. Some adjustments may be applied for factors like quality and transport to enhance comparability.

their own internal databases and/or acquired commercial databases. The good news is that more tax administrations are exchanging information with their peers for the control of TP (16 countries).

➢ Comparability adjustments used by taxpayers: Adjustments on accounts receivable, accounts payable, and inventory are frequently used. Other adjustments were used to a lesser extent, among them accounting reclassifications, used installed capacity, inventory valuation, intangible assets, monetary correction, and capitalized operational costs.

➢ Correlative adjustments: These types of adjustments, mainly legislated within the framework of DTCs, can be conducted in 13 LAC countries and avoid double taxation when a TP adjustment is implemented unilaterally. Despite its existence, to date only one country has implemented this type of adjustment (Argentina).

➢ APA implementation: Of the 13 countries that have the possibility of negotiating and signing APAs, only 6 have practical experience (Chile, Colombia, Dominican Republic, Ecuador, Mexico and Uruguay).

➢ Most used methods: Regardless of the context of the country, the economic sector and the level of development of the tax administration in the matter, the most used method by the tax administrations is the Transactional Net Margin Method (TNMM). The exceptions are Jamaica, which mainly applies the Cost-Plus Method (CPM); Brazil, which until last year applied fixed margins; Paraguay, which used a price adjustment formula before the reform, and El Salvador, which has a single method. If we analyze the application of methods by economic sector, the CUP is the most used method in LAC for the agricultural sector and, partially, for the mining, financial and vehicle repair sectors.

In addition to the need to harmonize regimes, there are numerous TP challenges facing the region. Figure 7 shows the evolution, during the years 2021 and 2022, of the barriers identified by tax administrations when applying their TP regimes.

The main barriers lie in the availability and access to information. However, international efforts have mitigated the limitations that tax administrations historically had to exchange information with their peers. For example, the barrier called "low or no existence of mutual assistance mechanisms between tax administrations" decreased significantly. Mutual assistance is understood to mean, for example, simultaneous tax audits, joint audits, audits abroad, etc. There are possibilities for improvement in this area, which are related to the commitments that governments expressed in the framework of the

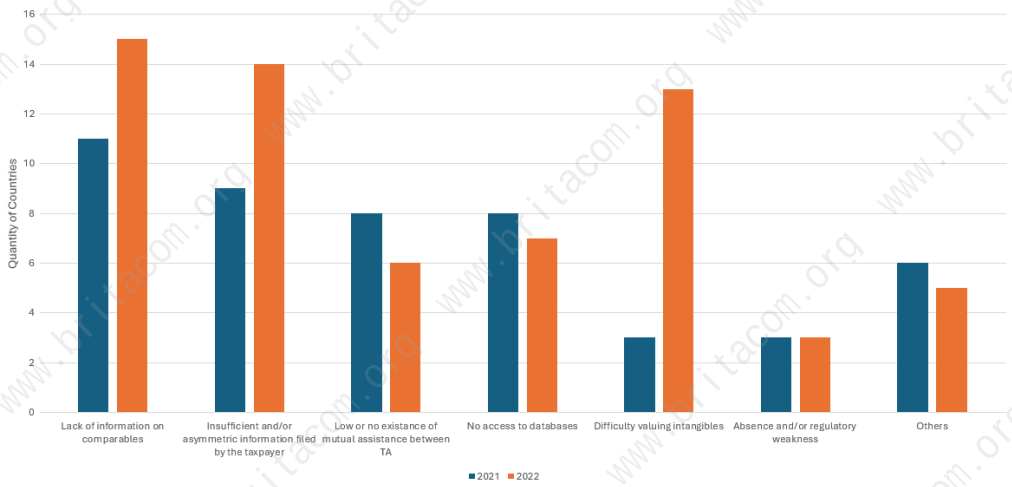

Figure 7. Main barriers identified by tax administrations in the LAC countries during the transfer pricing audit process

Source: Transfer Pricing Database. CIAT Data. CIAT, 2023.

Punta del Este Declaration,[7] whose objective is to maximize the use of information exchanged and make use of all cooperation modalities.

The absence of databases, for budgetary or other reasons, has also been a historical problem. During last year, some tax administrations have allocated resources to acquire commercial databases and to design internal databases. Another big problem is the difficulty in verifying information, which depends on the afore-mentioned barriers and the experience of the acting officials.

A challenge that has increased dramatically between 2021 and 2022 is the category "Difficulty in valuing intangibles". This would explain why, in recent years, more LAC countries adopted Action 8 of the BEPS Action Plan (8 countries).

3.4 The Evolution of Domestic and International General Anti-Avoidance Rules (GAARs)

The GAARs are an ideal tool to deal with known or even unknown cases of avoidance, which could be identified in the future, when there are no specific rules that are useful or case law. The advantage and disadvantage of GAARs lie in their wide scope. The great challenge for tax administrations is to provide certainty and objectivity in their application.

Currently, 13 LAC countries have such standards in their domestic legislation. Argentina was the first country to implement them in 1946. Mexico was the last to adopt it in 2020. These countries use various formulas or wording to achieve similar goals: substance over form, economic rationality, artificial transactions, economic reality, main purpose of the transaction, etc.

The experience is still limited, the rules only started being implemented in most countries from 2001 onwards and not all have practical experience. There is a wide margin for improvement, since there are good practices that are currently trending to generate certainty and achieve greater objectivity in their application. These include the publication of potentially abusive schemes (Chile and Peru), the publication of benchmark profit margins (Mexico), the design and implementation of domestic cooperative compliance programs (Brazil and Chile) and international compliance programs (Argentina, Chile and Colombia), the creation of GAAR implementation panels or committees (Chile) and the risk-based management approach (Chile).

New challenges related to the application of international GAAR standards are added to the existing challenges within the framework of DTCs. Action 6 of the BEPS Action Plan proposes the Principal Purpose Test (PPT) for transaction. This test was implemented in the DTCs of 14 LAC countries.

4. Final Considerations

Over the past two decades, LAC countries have shown an energetic political will to address the challenges of international taxation. Most countries have made steady progress, each at its own pace.

Currently, for almost all the tax administrations of LAC, the exchange of information under request does not constitute a limitation. Also, there are many countries that have provisions for tax purposes to access the ultimate beneficiary owner, exchange information automatically (CRS, FATCA, CbCR, etc.) and exchange rulings spontaneously (Action 5). However, mutual assistance (e.g., joint, simultaneous, external audits, etc.) remains a challenge for all LAC countries.

The BEPS Action Plan has generated significant interest, and it is expected that countries

7 The "Punta del Este Declaration" on Tax Transparency and Information Exchange is an initiative by 15 Latin American countries, supported by international organizations (CIAT, OECD, IDB, IFC, and World Bank), to combat tax evasion and promote fiscal equity. It emphasizes the importance of sharing financial and tax information through automatic exchange of information and beneficial ownership transparency. The declaration fosters regional cooperation, capacity building, and adherence to international standards, aiming to strengthen tax systems, enhance revenue collection, stop illicit financial flows and reduce Base Erosion and Profit Shifting (BEPS).

will continue to make progress in the adoption of actions and especially in their practical implementation. There is currently some uncertainty about the position that most LAC countries will take in relation to Pillars One and Two.

In the field of TP many countries have made steady progress. However, for some countries it is still a challenge to produce long-term strategies that allow for the maintenance of experienced teams and continuous improvements.

Given the levels of litigation generated by TP adjustments and consequently the high transaction costs, there is space to work on innovative reforms that allow the TP regime to be adapted to the practical possibilities of tax administrations, simplifying the procedures, generating greater certainty and avoiding disputes. Some ideas on this issue are provided in the "*Cocktail of Measures for the Control of Abusive Transfer Price Manipulation, with a Focus on the Context of Low-Income and Developing Countries*" prepared by CIAT in 2019 with the support of its International Taxation Network and the German Development Cooperation (GIZ).

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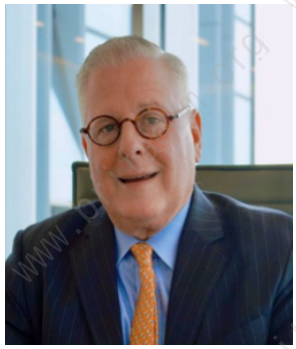
Five Principles for a Favorable Tax Environment:
The Example of Digital Services

Daniel A. Witt



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Abstract: This paper posits that five key principles serve as supports for a favorable tax environment: (1) tax policies and systems, including policies that give tax incentives; (2) tax certainty and the rule of law; (3) digitalization and other efforts that improve tax administration; (4) tax simplification, including simplification of compliance; and (5) steps to eliminate corruption from the system. Rates alone do not set the foundation for a favorable tax environment for investment. Using the digital services sector — a growing priority for economies and tax authorities — as a case study, the paper illustrates how these principles interconnect and underscores the role of tax policy in sectoral growth. It also provides practical suggestions for tax administrations in promoting a favorable tax environment for companies in this area, including measures to promote tax certainty and efficiency in tax administration.

Keywords: Growth; Tax incentives; Tax policy, Tax certainty; Tax administration; Digital services; Compliance; Corruption; VAT; B2B

Tax policy is a country's most important trade policy, according to Mr. H. Ohno Ruding, the former Finance Minister of the Netherlands. Trade policy has been much in the news recently. Countries, particularly many smaller countries, wonder how they can find new markets or expand into new industries with export opportunities if access to traditional markets faces new barriers. In this process, many people have come to the conclusion that tax policy is one of the most important trade policies of a country.

In this moment of uncertainty in international trade, therefore, trade ministers should make common cause with their counterparts in ministries of finance and tax administrations, because one essential underpinning to expanded trade and investment is a favorable tax environment.

This is so even as — perhaps especially as — negotiations for a new global tax arrangement including a global corporate minimum tax have dramatically slowed. But at the same time, that shift calls not for a return to an era of unbridled tax competition between countries for in-

Figure 1. Five principles for a favorable tax environment

vestment but rather for setting tax policy on a firm foundation designed to promote economic growth (Witt, 2024). Broadly, this effort has five principles, which serve as supports to the foundation, as illustrated in Figure 1.

To continue the architectural analogy, these supports do not stand alone but rather are joined; each reinforces the other and strengthens what lies above as in a Gothic cathedral. Or, in a slightly different analogy, the supports are pilings driven into the ground to stabilize the foundation of a skyscraper. Consider briefly how this is so:

Tax incentives, though tempting, should generally be disfavored. The private sector is better at knowing when and where to invest. Moreover, for investment to be sustainable, it must make sense in the absence of tax incentives and preferential policies. A simpler system is better. This leads to the next key principle, that of *tax certainty*. Investors should know how, when, why, and where they will be taxed. Resolution of disputes should be transparent and fair. Low headline rates mean little in practice if they cannot be realized or are undermined by exemptions or discriminatory tax regimes, leading to uncertainty.

Among the best policy choices to promote tax certainty and transparent taxation and resolution of tax disputes, therefore, is *digitalization of tax administration*, which makes obligations clear and provides records to ease *compliance*. Better compliance also arises when a tax administration sets a goal to serve taxpayers in an atmosphere of mutual trust rather than one of mutual suspicion that discourages both regular interaction between tax authorities and investors. The other four pillars work together to eliminate corruption in the system: reducing exemptions and preferences makes any corruption clearer, as does tax certainty, and corruption becomes far more difficult in a digitalized environment in which transactions are regularly recorded and easily audited, disputes are resolved transparently, and a tax authority has clear rules and guidance to work with investors in an atmosphere of mutual trust, in which information may be more readily shared.

Some may be surprised that to this point, this article on establishing a favorable tax environment has not discussed the question of tax rates. As noted above, tax incentives and differential rates may sound attractive, particularly in a context in which tax competition for investment may once again become possible in the absence of a new global tax framework. But rates, alone, do not set the foundation for a favorable tax environment for investment.

Of course, lower rates attract investment, but wise investors focus not only on rates but on the broader tax and investment environment which

a country offers. Low rates cannot make up for a lack of tax certainty, a slow and non-transparent dispute resolution system, or the danger of corruption that could ruin an investor's (and a country's) reputation. Equally, investors will look to see how revenues from higher rates are used — for instance, do they improve the infrastructure of a country so that export logistics are easy? Do they improve the education system to provide the skilled workforce that advanced projects required, including opportunities for women? Do they serve as funding for investments to improve the tax system itself, such as digitalization?

These principles, therefore, form a far better foundation for a tax system than competition based on rates alone or on attempts to target specific industries for tax incentives. Any tax incentives offered should ideally be highly targeted, of limited duration rather than permanent (to permit rigorous examination of whether they are achieving their aims) and designed to complement a modern system of compliance rather than to be the underpinning of that system.

How can countries put these principles into practice? As one important example, consider digital services. Virtually every country wants to grow its digital economy, and tax policy is an essential key to doing so.

To apply the principles in this case, the rule against tax incentives is easy: countries should not discriminate in taxation of digital services based on country of origin. Because many local competitors in this area are making competitive headway on either a national, regional, or in some cases even global level against the major global digital services companies, any discrimination in tax rates or policies simply serves to discourage competition and thus weakens the overall market, harming economic growth.

As in Thailand, the scope of a digital services tax should apply equally to all vendors, resident or not, who sell above a certain amount (here 1,800,000 THB or 54,869 USD). All sellers, again both resident and non-resident, should be included to help vendors understand when to collect VAT and thus promote compliance and discourage favoritism. Singapore, for instance, considers that if goods are shipped from outside the country to local consumers, vendors must collect VAT. This simple rule is easy for online platforms to understand and apply, giving revenue authorities confidence that VAT is, in fact, being collected appropriately.

Tax certainty and tax administration can be strengthened in the digital services space by key principles such as proper consultation with taxpayers and sufficient lead time as nations contemplate the extension of VAT into digital services for cross-border sales of digital products and then (in fewer cases) sales of goods, including low-value imported goods. Adoption of a Vendor Collection Model such as that in the OECD's "International VAT/GST Guidelines" (OECD, 2017) and elaborated in the "VAT Digital Toolkit for Asia Pacific" (OECD, 2022) may require greater lead time before collection actually begins. However, it also promises a smoother path once collection begins. A lead time of 12-18 months may be necessary not only for authorities to issue technical guidance but for vendors to build and implement systems for tax collection and compliance with customs rules. An overly rushed implementation schedule may lead to delay or an interim solution that weakens enforcement and confuses taxpayers, particularly in the transition from an interim to a permanent system, which could raise concerns over compliance.

Similarly, the system must be designed in a way that promotes simple compliance, again not discriminating against non-resident taxpayers, both to encourage the broadest possible investment in digital services and to reduce opportunities for, or the reality of, evasion and corruption. At the same time, vendors should not need to issue VAT invoices separately, as customer data is already captured during ordering.

This should apply for B2B purchases as well; if the vendor obtains the purchaser's tax identification number, it should not be further obliged to conduct further verification of its customer, as the business has a duty to report to the domestic tax authority. Here, coordinating the work of tax authorities and customs administrations provides a simpler, smoother process, so the customs

administration can verify VAT compliance at the border if it has access to the VAT registry (with the vendor marking the goods on which VAT has been paid). The goal is to ensure that goods on which the vendor has paid VAT are not subject to double taxation at importation while ensuring that VAT is paid at the border where it has not been collected by the vendor. This type of coordination between tax and customs authorities thus promotes simplification and reduces opportunities for evasion and corruption.

To further simplification, a shift to quarterly, rather than monthly, returns eases the compliance process for vendors of digital services; a solution to avoid double taxation (for instance at the border and through the vendor) is for the purchaser to claim repayment from the vendor and the vendor to make an adjustment in its next VAT filing to recover the tax. Alternatively, business purchasers could make the refund claim in their own VAT return, making the process even easier for vendors. In either case, vendors should not have to appoint a local fiscal representative or open a local bank account, to promote simplicity and ease of compliance. Ideally, tax authorities could also accept payments in the currencies of their major trading partners, using a standard commercial method acceptable to both parties, applied consistently to avoid evasion.

In all this, guidance from the IMF (IMF, 2021, 2023) gives examples of international best practices that countries can adopt. Singapore is a model in this regard, but other countries have taken important steps in this direction.

Similar examples could be drawn for other industries such as extractive industries, telecommunications, manufacturing, and agriculture, using the principles as a template to guide tax policy. Though the specifics of how the principles are applied will differ from industry to industry, the supports — and the principles behind them — will not. They form the foundation for a tax policy that attracts investment, ensures revenue growth, and discourages the corruption that both harms investment and deprives governments of the revenues to which they are entitled.

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Tax Policy and Investment Treaty Protection:
A Way to Reduce Risk of Investments (Part One)

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Abstract: Recently, Chinese President Xi Jinping called for reducing investment risks within jurisdictions of the Belt and Road Initiative (BRI). In this article, of which the second part will be published in a forthcoming issue of the *Belt and Road Initiative Tax Journal*, we aspire to respond to that call by focusing on one of the overarching and yet vastly under-explored areas of high relevance for reducing risks of investments: the interplay between tax policy and investment treaty protection. Our claim is that a wise tax policy factors in the impact of investment protection standards under international investment agreements (IIAs) on tax measures. To this end, it is advisable that ministries responsible for tax policy cooperate with those in charge for developing investments whenever tax measures concern inbound or outbound investments. In parallel, "tax administrations could develop technical expertise with respect to IIA disciplines through closer interaction with government departments in charge of the negotiation of IIAs and the defence of investor-state dispute settlement (ISDS) cases and vice versa."

Keywords: Tax policy; Investment treaty protection; International investment agreements (IIAs); Investor-state dispute settlement (ISDS); Reducing risks of investments; Strategic tax and investment planning

1. Raising Awareness of Tax Policymakers of Investment Treaty Protection

Tax policymakers and tax administrations are usually well versed in tax matters, including the way how double tax treaties (DTTs) impact their domestic agendas. They know that the principal purpose of DTTs is to facilitate cross-border investments by eliminating international double taxation without incentivizing tax avoidance and evasion.[1] It materializes by the set of rules that allocate taxation rights between contracting states over the income and capital gains from cross-border investments. Thus, having a large network of DTTs along with robust rules to prevent their abuse should be a high priority for tax policymakers who aim to create a friendly environment for local and international businesses. What they, however, most likely do not know very well is that international investment agreements (IIAs) may significantly impact tax policy ambitions.

The main goal of this contribution is to introduce tax policymakers and tax administrations to IIAs, and demonstrate that investment treaty protection under IIAs does not need to create tensions with an effective completion of their tasks. Knowing both the tax and investment worlds may in fact contribute to the peaceful coexistence of tax policies and investment treaty protection by following a "whole-of-government" approach in that regard. To use the words of United Nations (UN) expert, it "involves improving inter-departmental networks within governments, such as between tax agencies and investment ministries, as well as between tax policymakers and tax administrators".[2] Such approach enhances the rule of law and increases legal certainty in tax and investment domains.

This is a two-way road because investment policymakers may likewise benefit from understandings of taxation matters in domestic and international settings. As an illustration, it is worth considering the political agreement of the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework (IF) on a global minimum tax (Pillar Two),[3] which is a basis for implementation of Pillar Two rules in accordance with the OECD Pillar Two Model Rules by more than 140 countries and jurisdictions,[4] including a significant number of the Belt and Road Initiative (BRI) jurisdictions. In that regard, the United Nations Conference on Trade and Development (UNCTAD) urges governments to develop expertise on the interplay between Pillar Two and IIAs: "Expert knowledge of international legal obligations across different fields of specialization is necessary for governments to assess whether and how to engage in the renegotiation of incentives. [(…)] Most tax administrations could develop technical expertise with respect to IIA disciplines through closer interaction with government departments in charge of the negoti-

1 B. J. Arnold (2015). *An Introduction to Tax Treaties*, http://www.un.org/esa/ffd/wp-content/uploads/2015/10/TT_Introduction_Eng.pdf, para. 46 at p. 10.

2 A. Castonguay. *Draft Guidance for Officials — Attachment A, in Relationship of Tax, Trade and Investment Agreements. Co-Coordinators' Report* (Committee of Experts on International Cooperation in Tax Matters, Twenty-eighth Session New York, 19-22 March 2024), para. 82.

3 147 countries and jurisdictions as of the day of publication of this article. See OECD (2024). *Members of the OECD/G20 Inclusive Framework on BEPS, Updated: 28 May 2024*, https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf.

4 For the OECD's Pillar Two Model Rules with accompanied materials see: OECD (2021-2024). *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.htm.

ation of IIAs and the defence of investor-state dispute settlement (ISDS) cases and vice versa."[5]

Altogether, this article also aims to partly respond to the call of Chinese President Xi Jinping regarding the reduction of investment risks within the BRI jurisdictions.[6] Notably, President Xi emphasized importance of developing an "all-weather early-warning and risk assessment platform for China's overseas projects" and instructed relevant authorities to "step up management of overseas projects and risk control".[7] We believe that this wise policy statement could be partly operationalized by increasing the awareness of tax policymakers about investment treaty protection and investment policymakers of tax matters. Whenever domestic or foreign investors plan inbound or outbound investment, respectively, they always consider tax and investment treaty implications. There is no good reason why states hosting such investments (host states) as well as home states of investors (home states) shall not reflect that diligent approach in order to reduce investment risks within their territories.

In this Part One of the article, we present and analyze key characteristics of investment treaty protection and provide reasons why and how investment treaty protection is relevant for tax policymakers. Part Two of the article (forthcoming issue of the *Belt and Road Initiative Tax Journal* (BRITJ)) looks closely at the three selected investment treaty arbitration cases, which allow us to understand why and how legislative, executive and judicial fiscal power of states can be abused and, as a result, violate investment treaty protection. That final part of our article also provides conclusions consisting of the essential learning points stemming from the investment treaty world to tax policymakers.

2. Key Characteristics of Investment Treaty Protection

2.1 Scope and Purpose

IIAs have been concluded by states since the end of World War II. These agreements are divided into three types: (i) bilateral investment treaties (BITs); (ii) treaties with investment provisions (TIPs, e.g. the Energy Charter Treaty (ECT)[8] and free trade agreements with investment chapters); and (iii) investment-related instruments (IRIs).[9] Titles and preambles to the IIAs, especially BITs that constitute the vast majority of all IIAs, stipulate that their fundamental purpose is to protect and promote investment. For example, the title and preamble of the China-Turkey BIT (2015) read as follows:

5 UNCTAD (2023). *The Global Minimum Tax and Investment Treaties: Exploring Policy Options, IIA Issues Note 4/2023*, https://unctad.org/publication/global-minimum-tax-and-investment-treaties-exploring-policy-options, pp. 15-16. Tensions between Pillar Two and IIAs have also been noted by the OECD, see OECD (2022). *Tax Incentives and the Global Minimum Corporate Tax: Reconsidering Tax Incentives after the GloBE Rules*, https://doi.org/10.1787/25d30b96-en, pp. 50-52. See more on the interplay between Pillar Two and IIAs in B. Kuźniacki (2023). Pillar 2 and International Investment Agreements: "QDMMT Payable" Seals Internationally Wrongful Act. *Tax Notes International*, p. 159, https://ssrn.com/abstract=4598045. Cf. E. Visser, B. Kuźniacki & P. Schoueri (2024). Reducing the Tax Burden? Opportunity to Craft a Balanced Approach under Pillar Two. 5 *Belt and Road Initiative Tax Journal* 1, pp. 70-80, https://www.britacom.org/gkzljxz/dzqk/202406/P020240624597727902952.pdf; B. Kuźniacki & E. Visser (2024). Tax and Non-Tax-Related Challenges of Pillar 2 for Non-Advanced Economies. *Tax Notes International*, https://ssrn.com/abstract=4818304.

6 European Bank for Reconstruction and Development (EBRD). *Risk Assessment and Mitigation in Central Asia: Implications for Foreign Direct Investment and the Belt and Road Initiative*, https://www.ebrd.com/risk-assessment-mitigation-central-asia.pdf, p. 29. See also Xinhua (2021). *Xi Urges Continuous Efforts to Promote High-Quality BRI Development*, http://www.news.cn/english/2021-11/19/c_1310321353.htm.

7 Xinhua supra n. 6.

8 The ECT was opened for signature on 17 December 1994 and entered into force on 16 April 1998. *The Energy Charter Treaty*, https://www.energycharter.org/process/energy-charter-treaty-1994/energy-charter-treaty/.

9 UNCTAD. *International Investment Agreements Navigator* in: *Investment Policy Hub*, https://investmentpolicy.unctad.org/international-investment-agreements.

Title:

Agreement between the Government of the Republic of Turkey and the Government of the People's Republic of China Concerning the Reciprocal Promotion and Protection of Investments.

Preamble:

The Government of the Republic of Turkey and the Government of the People's Republic of China, hereinafter referred to as "the Contracting Parties".

Desiring to promote greater economic cooperation between them, particularly with respect to investment by investors of one Contracting Party in the territory of the other Contracting Party;

Recognizing that agreement upon the treatment to be accorded to such investment will stimulate the flow of capital and technology and the economic development of the Contracting Parties;

Having resolved to conclude an agreement concerning the encouragement and reciprocal protection of investments; Have agreed as follows.

The purpose of IIAs to promote investments is principally realized via the provisions that commit states to promote investments of foreign investors from other states (parties to the IIAs) by means of their protection. This *promotion by protection* approach is based on a set of investment protection standards that must be respected by the state hosting the investment (host state) such as fair and equitable treatment (FET), national treatment (NT), most-favored-nation treatment (MFN), the prohibition of illegal expropriation (direct & indirect), and umbrella clauses. Their scope and purpose will be briefly presented in section 3 below.

The investment promotion is to be achieved by the host state respecting the protection standards. The protection subsequently leads to a stable legal environment that favors foreign investments. By far, the IIA's most important and powerful enforcement tool is the right of individual investors to initiate arbitration against host states or what is known as the investment treaty arbitration or ISDS mechanism. It is usually included in the IIA under the heading "Submission of a Claim to Arbitration".[10] This tool ensures that host states will respect the standards of investment protection under the IIAs.[11] Otherwise, they may bear significant costs of defending and losing ISDSs which will negatively affect their investment climate.[12] Hence, the lack of IIAs may undermine the credibility of states trying to host investments and in any event may lead to increased risk related to investments in their territories and thus possibly the price of contemplated investments.[13] By contrast, a well-established network of IIAs sends a signal to foreign investors that a host state is credible vis-à-vis protection of their investments. It diminishes risk and price of both inbound and outbound investments. The longer and riskier the investment

10 From the tax and investment policy-oriented analysis of the UNCTAD follows that "[a]bout 95 per cent of IIAs provide for States' advance consent to international arbitration proceedings between an investor claimant and the respondent State. Investors can directly challenge State measures before an ISDS tribunal. Recourse to domestic courts or the exhaustion of local remedies is not required under most IIAs. Tax matters are generally not excluded from ISDS." See UNCTAD (2021). *International Investment Agreements and Their Implications for Tax Measures: What Tax Policymakers Need to Know*, https://investmentpolicy.unctad.org/publications/1245/international-investment-agreements-and-their-implications-for-tax-measures, p. 5.

11 J. W. Salacuse (2021). *The Law of Investment Treaties*. (3rd Edition). Oxford University Press, p. 111.

12 Ibidem, p. 161.

13 Ibidem. Cf. E. Fama (1970). Efficient Capital Markets: A Review of Theory and Empirical Work. 25 *J Fin* 2, pp. 383, 383-417; E. Fama (1991). Efficient Capital Markets: II. 46 *J Fin* 5, pp. 1575-1617.

is, the more important it is to secure its protection via IIAs. At the top of such investments are those in the energy sector, which are at the same time of strategic importance for states around the world.[14]

2.2 Controversies and the Way to Find a Balanced Approach

Despite the positive impact on investments by providing their protection, IIAs have been recently subject to a criticism in various regions for different reasons. For instance, the United Nations Commission on International Trade Law's (UNCITRAL) Working Group III on Investor-State Dispute Settlement Reform identified the concerns relating to the lack of consistency, coherence, predictability and "correctness" of arbitral decisions, double roles of arbitrators (counsel in one case, arbitrator in another one in parallel) as well as costs and duration of ISDS cases.[15] However, there are also voices according to which empirical evidence shows that the critical debate "about the right to private action granted to international investors through ISDS has frequently been based more on ideological views than on facts".[16]

The critical voices entered the gravity pool in some regions, e.g. in the European Union (EU) and India.[17] The example of India is particularly interesting for the purposes of this arti-

14 See T. Martin (2011). *International Dispute Resolution*, https://www.ipaa.org/wp-content/uploads/2016/12/IPAA_DisputeResolution2011.pdf; S. Vorburger & A. M. Petti (2018). Chapter 11: Arbitrating Energy Disputes, in M. Arroyo (ed.). *Arbitration in Switzerland: The Practitioner's Guide*. (2nd ed.). Alphen aan den Rijn: Kluwer Law International, p. 1277.

15 UNCITRAL. *Working Group III: Investor-State Dispute Settlement Reform*, https://uncitral.un.org/en/working_groups/3/investor-state. For specific concerns of developing countries, see K. Mohamadieh (2019). *Challenges of Investment Treaties on Policy Areas of Concern to Developing Countries*, https://www.southcentre.int/wp-content/uploads/2019/04/IPB17_Challenges-of-Investment-Treaties-on-Policy-Areas-of-Concern-to-Developing-Countries_EN.pdf. For a more academic view regarding the so-called treaty shopping under IIAs see A. Yilmaz Vastardis (2021). *The Nationality of Corporate Investors under International Investment Law*. Oxford: Bloomsbury Publishing, chapter 7.

16 R. Echandi (2019). The Debate on Treaty-Based Investor–State Dispute Settlement: Empirical Evidence (1987-2017) and Policy Implications. 34 *ICSID Review–Foreign Investment Law Journal* 1, p. 58. Cf. B. Stern (2020). Investment Arbitration and State Sovereignty. 35 *ICSID Review–Foreign Investment Law Journal* 3, p. 449.

17 In respect of EU, the key development was the Court of Justice of the European Union (CJEU) seminal judgment of 6 March 2018 in the *Achmea* case, which considered intra-EU investment treaty arbitration as incompatible with EU law because arbitral tribunals in the CJEU's view are not "tribunals" or "courts" in accordance to the EU Treaties. Thus, their interpretation of EU law escapes the CJEU's scrutiny. CJEU 6 March 2018, Case C-284/16, *Slowakische Republik (Slovak Republic) v. Achmea BV*, ECLI:EU:C:2018:158, paras 41-61. See critically about the CJEU's reasoning and methodology in the *Achmea* judgment in respect of an interplay between EU law and international investment law, among others, A. Gourgourinis (2018). After Achmea: Maintaining the EU Law Compatibility of Intra-EU BITs Through Treaty Interpretation. 3 *European Investment Law and Arbitration Review* 1, pp. 282, 287-302; E. Gaillard (2018). The Myth of Harmony in International Arbitration. 38 *Swiss Arbitration Association Bulletin*, pp. 763, 764-765; C. István Nagy (2018). Intra-EU Bilateral Investment Treaties and EU Law after Achmea: "Know Well What Leads You Forward and What Holds You Back". 19 *German Law Journal* 4, pp. 981-1016. After that judgment, the European Commission claimed that all intra-EU BITs are illegal (incompatible with EU law), resulting in the initiation of the process of termination of many intra-EU BITs under the 2020 termination agreement. See European Commission (2018). *Communication from the Commission to the European Parliament and the Council: Protection of Intra-EU Investment*, COM (2018) 547 final, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0547&rid=8; *Agreement for the Termination of Bilateral Investment Treaties Between the Member States of the European Union*, OJ L 169 (29 May 2020), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:22020A0529(01).

cle because of the multibillion USD tax-related cases — *Vodafone* and *Cairn*.[18] The loss of those cases prompted India to give a notice of termination of its BITs to at least 74 states since 2017 and released the India's Model BIT (2016) to replace the existing model from 2003. The new model, among others, seems to entirely exclude tax measures under a very broad tax carve-out under Article 2(4)(ii), completely omits the FET standard and obligates the investor to exhaust the domestic remedies for at least five years before commencing an arbitration under the BIT. Such extremely restrictive wording is unheard of in any BIT in the world. Hence, according to some authors, the India's Model BIT (2016) "seems more like a restatement of international law on sovereignty rather than a treaty meant to protect cross-border commercial transactions".[19]

In our view, the balanced approach is preferable: the concerns stemming from IIAs should be neither over- nor under-stated. In respect of the interplay between IIAs and tax policy, although the UNCTAD recommends to tax and investment policymakers to reduce the exposure of tax measures to the FET standard, it ultimately acknowledges that "the FET clause does not preclude States from adopting good faith regulatory or other measures that pursue legitimate policy objectives."[20] Thus, in our view, the FET standard does not make wise tax policy vulnerable to investment treaty arbitration. In other words, states can implement tax measures in good faith and for legitimate policy objectives without any non-negligible risk of running afoul of the FET. This observation is valid to all standards of investment treaty protection. We provide more guidance in that regard in sections 1 and 5 of the Part Two of the article (forthcoming issue of the BRITJ).

2.3 The Chinese Position and Specific Context of Investments in BRI Jurisdictions

The number of BRI jurisdictions is currently over 150.[21] It goes beyond this article to look closer at their positions toward IIAs. However, we will briefly do so in relation to China, which is leading the Belt and Road Initiative Tax Administration Cooperation Mechanism (BRITACOM).[22] We will then highlight a context of investments in BRI jurisdictions.

China has one of the largest networks of IIAs in the world with 147 BITs and 52 other IIAs of lesser relevance but still of importance

18 *Vodafone International Holdings BV v. India (I)* (PCA Case No. 2016-35) (Award) (25 September 2020); *Cairn Energy PLC and Cairn UK Holdings Limited v. Republic of India*, UNCITRAL, PCA Case No. 2016-7, Award (21 December 2020). See an in-depth analysis of the *Cairn v. India* case, which is of high relevance also to the *Vodafone v. India* case (unpublished) B.Kuźniacki & S. van Weeghel (2023). When Retroactive Taxation Not Justified by Prevention of Tax Avoidance Is Unfair and Inequitable. 39 *Arbitration International* 1, https://doi.org/10.1093/arbint/aiad003.

19 See Abhishek Dwivedi (2020). India's Flawed Approach to Bilateral Investment Treaties. *The Diplomat*. See also Douglas Thomson (2014). Vodafone Claim Still on after India Rules out Tax Law Change. *Global Arb Rev*.; Cairn's Tax Liability Credit Negative for Vedanta: Moody's. *The Indian Express* (17 March 2015); Grant Hanessian & Kabir Duggal (2015). The 2015 Indian Model BIT: Is This Change the World Wishes to See?. 30 *ICSID Rev-FILJ* 3, pp. 729, 735.

20 UNCTAD (2021). *International Investment Agreements and Their Implications for Tax Measures: What Tax Policymakers Need to Know*, https://investmentpolicy.unctad.org/publications/1245/international-investment-agreements-and-their-implications-for-tax-measures, reform option 4.3.3, the third indent at p.28.

21 *Building an Open, Inclusive and Interconnected World for Common Development*, https://www.mfa.gov.cn/mfa_eng/xw/zyxw/202405/t20240530_11332357.html.

22 The BRITACOM was established by initiative of China, which is still a driving force of that organization. The BRITACOM consists of the Council, the Secretariat, the Belt and Road Initiative Tax Administration Cooperation Forum (BRITACOF), and the Belt and Road Initiative Tax Administration Capacity Enhancement Group (BRITACEG), https://www.britacom.org/jzgk/britacom/.

to protect foreign investments.[23] Considering this large network of IIAs and the size of the Chinese economy, Professor Diane Desierto predicts that China would soon become "a global ISDS power": "Given the vast magnitude, territorial coverage, and generational duration of the BRI projects, however, China is nonetheless very likely to assume global dominance in the writing and rewriting of future international investment rules and especially ISDS. Current multilateral reform efforts at UNCITRAL (where China is also represented) may eventually be outpaced, however, by the practical and operational realities of China's dominance in foreign investment and rule-making around the world for decades to come."[24]

Many of Chinese BITs are in force with EU Member States, including the Netherlands, Germany, Sweden, Spain, Italy, and Poland.[25] China has also signed IIAs with major non-EU economies like the United Kingdom and Japan as well as with non-EU investment hubs, e.g. Switzerland. Chinese IIAs reach also African states, e.g. Nigeria, Ghana, Morocco, Egypt, and Mozambique, and South American states, e.g. Peru and Argentina. Thus, Chinese investments in those states and investments coming from those states into China are protected by the large network of Chinese IIAs. This protection is by no means dormant. So far Chinese investors have initiated 19 ISDS proceedings under IIAs against host states while nine ISDS proceedings have been initiated by foreign investors against China as a host state.[26] At least seven Chinese mainland investors have brought ISDS claims against host states since 2020, which indicates increasing dynamics in that regard.[27] This shows that ISDS mechanism under IIAs is recently of increasing relevance for investments originating in China and made in other states, including many BRI jurisdictions. It is also noteworthy that so far ISDS cases initiated by foreign investors against China have never been decided against that state. Two were decided in favor of China, one was settled, one discontinued and five are still pending.

Scholars point out that the nature of the projects as well as their financial and political characteristics predispose BRI projects to cross-border disputes of large magnitudes, including those subject to ISDS.[28] In particular, the

23 UNCTAD. *International Investment Agreements Navigator* in: *Investment Policy Hub*, https://investmentpolicy.unctad.org/international-investment-agreements/countries/42/china.

24 D. A. Desierto (2018). *China as a Global ISDS Power*, https://oxia.ouplaw.com/page/715.

25 This, for example, allows Chinese multinational enterprises (MNEs) to consider protection under those IIAs against EU anti-dumping and safeguard measures targeted by the European Commission at Chinese major producers of battery electric vehicles (BEV). See European Commission (2024). *Commission Investigation Provisionally Concludes That Electric Vehicle Value Chains in China Benefit from Unfair Subsidies*, https://ec.europa.eu/commission/presscorner/detail/en/ip_24_3231. Ursula von der Leyen, President of the European Commission, said on 4 October 2023 that EU measures will be applied "in full respect of our EU and international obligations — because Europe plays by the rules, within its borders and globally. This anti-subsidy investigation will be thorough, fair, and fact-based." See European Commission (2023). *Commission Launches Investigation on Subsidised Electric Cars from China*, https://ec.europa.eu/commission/presscorner/detail/en/ip_23_4752. Hence, Chinese MNEs shall legitimately expect that the international obligations of EU Member States under IIAs with China will be respected. This regards EU Member States which will impose and collect anti-dumping levies from Chinese MNEs.

26 UNCTAD. *Investment Dispute Settlement Navigator* in: *Investment Policy Hub*, https://investmentpolicy.unctad.org/investment-dispute-settlement/country/42/china/investor.

27 Ibidem. See also S. Gáspár-Szilágyi (2024). When the Dragon Comes Home to Roost: Chinese Investments in the EU, National Security, and Investor–State Arbitration. 15 *Journal of International Dispute Settlement* 2, pp. 195-220, https://doi.org/10.1093/jnlids/idad028.

28 M. Gotsiridze (2024). Multiple Proceedings and Abuse of Procedure on BRI Disputes. 15 *Journal of International Dispute Settlement* 1, p. 144; M. Du (2022). Explaining China's Approach to Investor-State Dispute Settlement Reform: A Contextual Perspective. 28 *European Law Journal* 4-6, pp. 295-296, https://doi.org/10.1111/eulj.12468.

investments in BRI jurisdictions include a vast network of railways, energy pipelines, highways and streamlined border crossings both westward and southward, as well as investments in port development along the Indian Ocean, from Southeast Asia all the way to East Africa,[29] reaching nearly USD1 trillion since its inception in 2013 until 2023.[30] At least some of those projects may be prone to ISDS tax-related disputes in whole or in part, i.e. disputes concerning "alleged violations of an investment treaty resulting from certain sovereign measures taken by the Respondent in the field of taxation".[31]

Tax-related ISDS claims that have arisen under IIAs are diverse and include both purely tax-related claims, e.g. due to withdrawal of tax incentives and introduction of windfall profit taxes, and those intertwined with non-tax measures, such as forced liquidation, the lack of permission for conducting a transaction (e.g. an acquisition), or termination of permission for conducting certain business activities (e.g. gambling or exploitation of oil & gas). Tax-related ISDS cases may also overlap with the subject matter covered by DTTs and the mutual agreement procedures (MAPs).[32] In such cases, some IIAs exclude all investment treaty protection standards by means of clauses which ensure prevalence to DTTs to the extent of the inconsistency between DDTs and IIAs, or by excluding certain standards of investment treaty protection only. An example of the former is Art. 21(5) Rwanda-US BIT (2008): "Nothing in this Treaty shall affect the rights and obligations of either Party under any tax convention. In the event of any inconsistency between this Treaty and any such convention, that convention shall prevail to the extent of the inconsistency."[33] An example of the latter (partial) exclusion in favor of DTTs is Art. 3(3)(ii) of the China-Kazakhstan BIT (1992), which says: "The provisions of paragraphs 1 and 2 of this Article [FET & MFN] shall not apply to privileges and immunities accorded or to be accorded by a Contracting Party to any investor or investment of a third State on the basis of:

29 A. Chatzky & J. McBride (2023). *China's Massive Belt and Road Initiative Backgrounder, Council on Foreign Relations Report*, http://dx.doi.org/10.1007/978-3-031-16659-4_16. Some of the recent examples of BRI projects of such character include: 756-km Addis Ababa-Djibouti Railway, connecting Ethiopia to the Gulf of Aden; the overland route from Kashgar in Xinjiang, China, to Gwadar Port in Pakistan; Jakarta-Bandung high-speed railway in Indonesia worth of USD5.29 billion; 22.5-km second Penang Bridge in Malaysia. See CDR (2021). *BRI Project Disputes at HKIAC: The Story So Far*, https://iclg.com/cdr-essential-intelligence/1100-cdr-the-belt-and-road-initiative-2021/2-bri-project-disputes-at-hkiac-the-story-so-far; CDR (2021). *The Use of Litigation Finance in Disputes Along China's Belt and Road*, https://iclg.com/cdr-essential-intelligence/1100-cdr-the-belt-and- road-initiative-2021/5-the-use-of-litigation-finance-in-disputes-along-china-s-belt-and-road.

30 C. Nedopil (2023). *China Belt and Road Initiative (BRI) Investment Report 2022*, https://greenfdc.org/china-belt-and-road-initiative-bri-investment-report-2022/.

31 Compare with tax disputes, which are solved via domestic litigation or mutual agreement procedures (MAPs). They concern "the taxability (including the tax-amount) of a specific transaction". See Cairn supra n. 18, para. 793. See more on a distinction between tax disputes and investment treaty tax-related disputes in K. Bhukya (2024). Threading Between Scylla and Charybdis: Developing a Framework for Arbitrating Investor-State Tax Disputes. *Arbitration International*, pre-published online.

32 UNCTAD (2022). *Facts on Investor–State Arbitrations in 2021: With a Special Focus on Tax-Related ISDS Cases*, https://investmentpolicy.unctad.org/publications/1266/facts-on-investor-state-arbitrations-in-2021-with-a-special-focus-on-tax-related-isds-cases, pp. 5-6.

33 See also Art. 21(4) of the 2012 US BIT Model (https://ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf) and Art. 11(2) Canada's 2021 Foreign Investment Promotion and Protection Agreement (FIPA) Model (https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/2021_model_fipa-2021_modele_apie.aspx?lang=eng).

International agreements on taxation and other tax treaties."[34]

3. Relevance of Investment Treaty Protection for Tax Policymakers

3.1 Significance of ISDS Tax-Related Cases

According to the UNCTAD's statistics, ISDS has grown significantly over the past 25 years as a method to solve disputes between private investors and states, with dramatically increasing ISDS tax-related disputes.[35] The figures below illustrate those dynamics.[36] It follows from them that around 15%~17% of all ISDS cases are tax-related. This is a significant percentage. Even more significantly, some of the largest arbitral awards rendered in favor of investors in the history of ISDS have been based on tax-related (mis)conduct of host states toward investors, e.g. a series of *Yukos and others v. Russia* cases — USD50 billion (the largest award ever rendered),[37] *Occidental v. Ecuador (II)* — USD1.77 billion,[38] *Cairn*

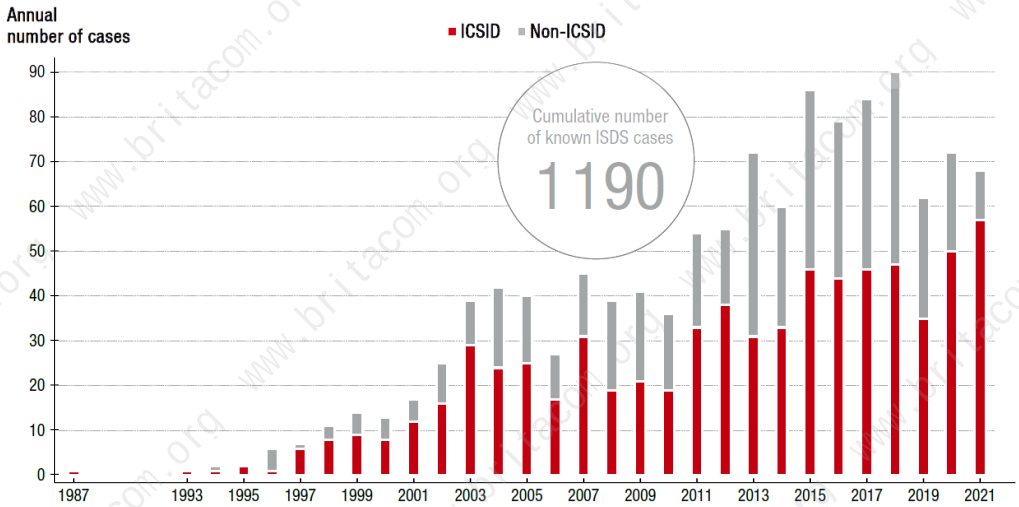

Figure 1. All ISDS cases by 2021

Source: UNCTAD (2022). *Facts on Investor–State Arbitrations in 2021: With a Special Focus on Tax-Related ISDS Cases,* https://investmentpolicy.unctad.org/publications/1266/facts-on-investor-state-arbitrations-in-2021-with-a-special-focus-on-tax-related-isds-cases, p. 1.

34 *China-Kazakhstan BIT (1992)*, https://edit.wti.org/document/show/2331ea73-24ec-400b-ae99-b14961526db6.

35 UNCTAD supra n. 32, p. 1.

36 The figures reflect all publicly known ISDS cases, which mean that there are also publicly unknown ISDS cases. Hence, the actual numbers of all ISDS cases and ISDS tax-related cases are higher. ICSID stands for the International Centre for Settlement of Investment Disputes, which is an international arbitration institution established in 1966 for legal dispute resolution and conciliation between international investors and States. See more: https://icsid.worldbank.org/about. The UNCTAD also notes in respect of the figures that: "Information has been compiled from public sources, including specialized reporting services. UNCTAD's statistics do not cover investor–State cases that are based exclusively on investment contracts (State contracts) or national investment laws, or cases in which a party has signaled its intention to submit a claim to ISDS but has not commenced the arbitration. Annual and cumulative case numbers are continually adjusted as a result of verification processes and may not match exactly case numbers reported in previous years."

37 *Yukos Universal Ltd (Isle of Man) v. Russian Federation*, PCA AA 227, Final Award (18 July 2014); *Veteran Petroleum Ltd (Cyprus) v. Russian Federation*, PCA AA 228, Final Award (18 July 2014); *Hulley Enterprises Ltd (Cyprus) v. Russian Federation*, Permanent Court of Arbitration (PCA) AA 226, Final Award (18 July 2014).

38 *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Republic of Ecuador (II)*, ICSID Case No. ARB/06/11, Award (5 October 2012).

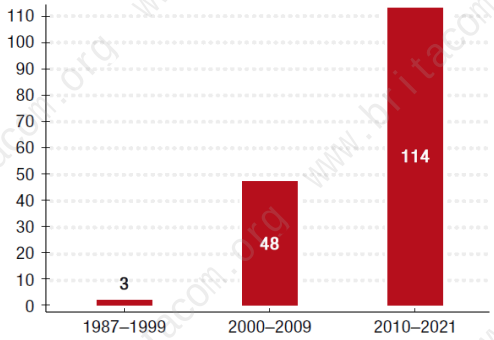

Figure 2. All ISDS tax-related cases by 2021
Source: UNCTAD (2022). *Facts on Investor–State Arbitrations in 2021: With a Special Focus on Tax-Related ISDS Cases*, https://investmentpolicy.unctad.org/publications/1266/facts-on-investor-state-arbitrations-in-2021-with-a-special-focus-on-tax-related-isds-cases, p. 5.

v. India — excess of USD1.2 billion,[39] and *Stati and others v. Kazakhstan* — USD497 million.[40]

Top six industries in which ISDS claims arise in tax-related cases are: 1) oil, gas & mining, 2) other industry (mainly the food and beverage), 3) information & communication, 4) electric power & other energy, 5) construction, and 6) services & trade.[41] These statistics cannot be overstated by China and other BRI jurisdictions because they make major investments exactly in those industries.[42]

The oil, gas & mining industry constitutes the biggest risk for ISDS claims in general, and specifically in ISDS tax-related claims because of its usually high to very high taxation and investment characteristics. They are large-scale, long-term, and capital-intensive undertakings with an average life span ranging between 10 and 40 years.[43] A combination of the long-term nature of projects in the energy sector with the significant upfront investments that they might require, increases many risks, including geological, technical, political, environmental, operational, legal and economic risks.[44] Those risks, especially environmental ones, may turn into disputes between foreign investors and host states, whenever the states modify their law to effectuate new environmental or other policy goals so that it negatively affects other investments,[45] for instance by imposing windfall taxes on extraordinary profits from oil & gas[46] and prospectively new environmental taxes.[47] Indeed, some of the largest ISDS disputes to date in terms of the magnitude of claims and awards regarded the energy sector (extraction of crude petroleum and natural gas),[48] which make them impossible to overlook by BRI jurisdictions, especially in light of the 2021-2022 global energy crisis and the ongoing

39 *Cairn* supra n. 18.

40 *Ascom Group S.A., Anatolie Stati, Gabriel Stati and Terra Raf Trans Traiding Ltd. v. Republic of Kazakhstan*, SCC Case No. 116/2010, Award (19 December 2013).

41 D. Morris, Y. Kryvoi, S. Winter-Barker, et al. (2024). *Tax-Related Measures in Investor-State Arbitration*, https://www.biicl.org/newsitems/16502/biicl-publishes-new-study-on-taxation-measures-in-investment-disputes, pp. 17-18.

42 See supra sec. 2.3 in fine.

43 See Martin supra n. 14.

44 See Vorburger & Petti supra n. 14, p. 1277.

45 E. Aleynikova, T. Timonen & E.G. Pereira (eds) (2022). *Governing Law and Dispute Resolution in the Oil and Gas Industry*. Edward Elgar Publishing, p. 2.

46 J. Lammers & B. Kuźniacki (2023). The EU Solidarity Contribution and a More Proportional Alternative: A Study under EU and International Investment Law. 51 *Intertax* 6/7, sec. 5.

47 Cf. M. F. Bashir, A. Sharif, M. W. Staniewski, et al. (2024). Environmental Taxes, Energy Transition and Sustainable Environmental Technologies: A Comparative OECD Region Climate Change Analysis. 370 *Journal of Environmental Management* 11, https://doi.org/10.1016/j.jenvman.2024.122304.

48 See, for example: *Cairn* supra n. 18; *Yukos v Russia* cases supra n. 37; *Occidental* supra n. 38; and *Stati and others* supra n. 40.

energy transition.[49]

In regard to the last point, it is worth noting that China emerges as the world's leading investor in the energy transition: from 2010 to 2019 China reported USD818 billion in renewable energy investments in comparison with USD392 billion by the US and USD719 billion by all European countries together.[50] Hence, the energy sector shall clearly be the top priority for China and other BRI jurisdictions in respect of the reduction of investment risks, including the risk stemming from tax policy. Indeed, an abrupt change in tax policy and other regulatory modifications regarding investments in renewable energy can trigger an avalanche of ISDS cases.[51] Within tax policy, most sensitive to investments are changes that affect different taxes at once or those related to corporate income tax.[52] Thus, the focus of tax policymakers could be on the tax system as a whole, perhaps with special care for taxes imposed on companies and their branches, which are investment vehicles covered by IIAs.[53]

3.2 Standards of Investment Treaty Protection of Most Relevance for Tax Policymakers

The claims against tax measures are in practice most likely to fall under IIAs due to alleged violations of one or a combination of the following standards of investment treaty protection: 1) fair and equitable treatment (FET); 2) indirect expropriation; 3) national treatment (NT); and 4) umbrella clauses.[54]

Investors most frequently invoke the FET standard, either as a standalone claim or in combination with other standards, in general and in tax-related claims (over two-thirds of all tax-related claims).[55] Scholars consider the FET "the most important standard in investment disputes".[56] This reputation appears to follow from the very design of the FET clauses: they are the broadest, the most capacious and the most flexibly phrased investment treaty protection clauses of all included in IIAs. For example, Art. 3(1) of the China-Mozambique BIT (2001) says: "Investments and returns of investors of either

49 UN (2023). *COP28 UAE Leaders' Declaration on a Global Climate Finance Framework*, https://www.cop28.com/en/climate_finance_framework; UN (2023). *COP28 Ends with Call to 'Transition away' from Fossil Fuels; UN Chief Says Phaseout Is Inevitable*, https://unsdg.un.org/latest/stories/cop28-ends-call-%E2%80%98transition-away%E2%80%99-fossil-fuels-un-chief-says-phaseout-inevitable.

50 UN Environment Programme (2020). *Global Trends in Renewable Energy Investment 2020*, https://www.fs-unep-centre.org/wp-content/uploads/2020/06/GTR_2020.pdf, p. 31.

51 For a comprehensive overview of more than 30 arbitral decisions in European renewable energy cases see: J. Biggs (2021). The Scope of Investors' Legitimate Expectations under the FET Standard in the European Renewable Energy Cases. 36 *ICSID Review* 1, pp. 99–128.

52 See Morris et al. supra n. 41, pp. 19-20.

53 In principle, a company meets a definition of "an investor" under an IIA. For example, Art. 1(2)(b) and (10)(a) of the China-Canada BIT (2012) says: "For the purpose of this Agreement, [(…)] 'investor' means with regard to either Contracting Party: (b) any enterprise as defined in paragraph 10(a) of this Article; that seeks to make, is making or has made a covered investment. [(…)] An 'enterprise' means: any entity constituted or organized in accordance with the laws of a Contracting Party, such as public institutions, corporations, foundations, agencies, cooperatives, trust, societies, associations and similar entities and private companies, firms, partnerships, establishments, joint ventures and organizations, whether or not for profit, and irrespective of whether their liabilities are limited or otherwise; and a branch of any such entity."

54 See Morris et al. supra n. 41, p. 20.

55 Ibidem.

56 See C. Schreuer (2005). Fair and Equitable Treatment in Arbitral Practice. 6 *Journal of World Investment & Trade* 3, p. 357.

Contracting Party shall at all times be accorded fair and equitable treatment."[57]

After analyzing a rich body of investment treaty case law, Professor Stephan Schill concluded that arbitral tribunals have identified the following core principles of the FET standard: "(1) the requirement of stability, predictability and consistency of the legal framework, (2) the principle of legality, (3) the protection of investor confidence or legitimate expectations, (4) procedural due process and denial of justice, (5) substantive due process or protection against discrimination and arbitrariness, (6) the requirement of transparency, and (7) the requirement of reasonableness and proportionality."[58]

A violation of the FET standard by a state may be caused by the breach of only one of the core elements of that standard, e.g. legitimate expectations or non-discrimination,[59] albeit it may vary depending on facts and circumstances.[60]

The second most frequently invoked standard of investment treaty protection in tax-related cases is the prohibition of illegal indirect expropriation. It is indirect expropriation because it is done via tax measures. It is illegal when a host state disposes an investor of its investment without prompt, adequate and effective compensation. In principle, IIAs do not preclude states from expropriating investments as long as the taking is for a public purpose, in a non-discriminatory manner, under due process of law and against the payment of compensation.[61] For example, Art. 4(1) of the China-Morocco BIT (1995)[62] says: "Measures of nationalization, expropriation or any other measure having the same effect or character (hereinafter referred to as 'expropriation'), which may be taken by the authorities of one of the Contracting Parties against investments made by investors of the

57 This BIT should be of high importance for China insofar as *Global Times* reports that China became one of the largest sources of investment in Mozambique. There were more than 100 Chinese companies in Mozambique, in the fields of infrastructure, energy, mining, agriculture, manufacturing, tourism, telecommunications and digital television. Nonfinancial direct investment reached USD1.997 billion, and total investment was almost USD8 billion by 2020. See W. Hejun (2020). *China-Mozambique Cooperation Yields Numerous Benefits*, https://www.globaltimes.cn/content/1206694.shtml.

58 S. Schill (2005). Fair and Equitable Treatment under Investment Treaties as an Embodiment of the Rule of Law. 3 *Transnational Dispute Management* 5, p. 11, as cited in *Cairn* supra n. 18, para. 1722. See also: *Petrobart Limited v Kyrgyzstan*, SCC Case No 126/ 2003, Award (29 March 2005) para 75; *Philip Morris v. Uruguay*, ICSID Case No. ARB/10/7, Award (8 July 2016) Concurring and Dissenting Opinion of Arbitrator Born (28 June 2016), paras 40-42, 51, 57, 61-62, 69, 81, 133. See also OECD. *Draft Convention on the Protection of Foreign Property, Text with Notes and Comments art 3 Commentary 5(a), (b), art 1 Commentary 4(a)*, https://icsid.worldbank.org/sites/default/files/parties_publications/C3765/Claimants%27%20Amended%20Memorial/Legal%20Authorities/CL-0020.PDF.

59 Cf. P. Dumberry (2020). *A Guide to General Principles of Law in International Investment Arbitration*. Oxford University Press, p. 337.

60 Cf. *Kuntur Wasi and Corporación América v. Peru*, ICSID Case No. ARB/18/27, Decision on Jurisdiction, Liability and Certain Aspects of Quantum, With Further Directions on Quantum (11 August 2023), para. 673: "In the Tribunal's view, FET claims are highly factual in nature. They involve an assessment of whether the conduct of a State, viewed in its totality, has crossed a line from permissible to impermissible in relation to the investor's legitimate expectations. It is not a case of a Tribunal substituting its own judgment for the policy or other decisions of the State, but rather looking for those facts and circumstances that are probative on the question of whether key factors, reflecting fundamental principles of international law, have been violated."

61 UNCTAD supra n. 5, p. 13.

62 See J. Wildsmith (2024). *China Shifts to Capital Exports*, https://www.fdiintelligence.com/content/feature/china-shifts-to-capital-exports-83834.

other Contracting Party, must meet the following conditions:

a) they are taken in the public interest;

b) they shall be subject to a legal procedure;

c) they shall not be discriminatory; and

d) they shall give rise to the payment of compensation."

This standard of investment treaty protection is relevant for investors whenever a tax assessment exceeds the capacity of the local investment entity to pay tax, thereby threatening the entity's solvency, leading to the permanent loss of ownership or control over that investment by a foreign investor. In such instances, taxation renders investment worthless and unviable and thus subject to application of the expropriation clause under relevant IIAs.[63]

The threshold of indirect expropriation in ISDS tax-related cases is very high. So far the arbitral tribunals rejected tax-related claims concerning expropriation even in cases in which taxation reached 99% of extraordinary profits in the energy sector (crude petroleum),[64] observing that "it will only be in an extreme case that a tax which is general in its incidence could be judged as equivalent in its effect to an expropriation of the enterprise which is taxed".[65] Such an extreme case was *Yukos and others v. Russia* at which we take a closer look in section 2 of Part Two of the article (forthcoming issue of the BRITJ). According to the arbitral tribunal, it represented the tax measure in bad faith (*mala fide*) and thus an abuse of executive state's fiscal power (i.e. power to tax).

The next standard of investment treaty protection in tax-related cases worth attention is national treatment (NT). It precludes *de iure* and *de facto* discriminatory treatment of foreign investments in comparison with domestic ones in like circumstances.[66] An example of an NT clause is in Art. 3(2) of the China-Saudi Arabia BIT (1996), which says: "Subject to its laws and regulations, each Contracting Party shall grant investments once admitted and investment returns of the investors of the other Contracting Party a treatment not less favorable than that accorded to investment and investment returns of its investors."[67]

63 Cf. *Burlington Resources, Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5, Majority Decision on Liability (14 Dec. 2012), para. 456; *Horthel Systems BV, Poland Gaming Holding BV and Tesa Beheer BV v. Poland*, PCA Case No. 2014-31, Final Award (16 Feb. 2017), para. 256; *Stati* supra n. 40, paras 1205-1207, 1799. In literature see A. Lazem & I. Bantekas (2022). The Treatment of Tax as Expropriation in International Investor–State Arbitration. 38 *Arbitration International* 1-2, pp. 85-130; C. Marian (2020). *The State's Power to Tax in the Investment Arbitration of Energy Disputes: Outer Limits and the Energy Charter Treaty*. Kluwer Law International, pp. 55 et seq.

64 In the case *Burlington* supra n. 63, the arbitral tribunal concluded in paras. 422, 450 that a tax of 99% on windfall profits was not tantamount to expropriation insofar as it only "considerably diminished Burlington's profits, but does not prove that Burlington's investment became unprofitable or worthless". Similarly, in *Perenco Ecuador Ltd v. The Republic of Ecuador and another*, ICSID Case No. ARB/08/6, Decision on Remaining Issues of Jurisdiction and on Liability (12 September 2014), the arbitral tribunal observed in para. 685 that "the financial burden of paying 99% of the revenues above the reference price, while disadvantageous to Perenco, did not bring its operation to a halt or, to revert to the tests previously cited, effectively neutralise the investment or render it as if it had ceased to exist".

65 *EnCana Corporation v. Republic of Ecuador*, (LCIA Case No. UN3481), Award (3 February 2006), para. 173. However, in the very same case the tribunal concluded in para. 200 that the host state violated the FET standard, which shows that even if there is no expropriation, but close to it, another standard of investment treaty protection can likely be violated.

66 S. Castagna (2023). Comparing Comparability: A Study of EU, ISDS, and WTO Tax 'Like' Cases. 51 *Intertax* 6/7, pp. 487-505.

67 See Wildsmith supra n. 62.

The ISDS case law in tax-related cases[68] indicates that the effect of taxation that discriminates foreign investments against domestic ones violates NT. This applies also to the so-called tax protectionism of public sector, i.e. state owned or controlled companies in a given sector are taxed more favorably than foreign privately owned or controlled companies. For example, the arbitral tribunal in the *Archer Daniels Midland v. Mexico* case decided under the North American Free Trade Agreement (NAFTA) that an imposition of 20% tax only on high fructose corn syrup (HFCS) but not sugar cane was "discriminatory and contrary to the national treatment principle under Article 1102. The Tax was applied in a way that afforded protection to the domestic cane sugar industry, targeting the HFCS industry, which is largely owned by foreign U.S. investors, including the Claimants. [(…)] Many of the sugar refineries in Mexico are owned and controlled by the Government. Sugar cane fields and sugar refineries are spread throughout the country. [(…)] Similarly, consumption of non-Mexican cane sugar during the period the Tax was in force is basically non-existent."[69]

Investors can also protect their investments against tax measures under umbrella clauses. Irrespective of alleged violations of the FET standard, the state's promises may be brought under the protective scope of IIAs via so-called umbrella clauses because such clauses oblige the host states "to comply with obligations the state has entered into with respect to investments protected by the treaty in which the umbrella clause is found."[70] In the absence of an umbrella clause, a violation of contractual obligations by the host state would not be covered by the IIA, unless that violation is so severe that it violates any of the IIA's standards of investment protection *per se*.[71]

An umbrella clause is important for investors aiming to challenge tax measures because it may open a separate door for claims based on an IIA via which it is easier to prevail in ISDS proceedings than by relying on remaining standards of investment protection.[72] That is why investors often look for state's promises to include specific provisions in investment agreements such as tax stability provisions, set-off clauses, adjustment clauses, advance tax rulings, or any other agreements relating to the tax treatment of its investments in order to be better protected against unforeseen tax measures.[73] Of importance to the protective effect of umbrella clauses against tax measures is the observation stemming from ISDS case law according to which only when the host state acts in its capacity as sovereign (by contrast to an act of private nature) will an umbrella clause equate a breach-of-contract claim to a breach-of-treaty claim.[74] States always act in their capacity as a sovereign while applying tax measures, which implies that umbrella clauses

68 *Archer Daniels Midland and Tate & Lyle Ingredients Americas, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/04/5, Award (21 Nov. 2007); *Corn Products International, Inc. v. United Mexican States*, Award (18 August 2009), ICSID Case No. ARB(AF)/04/1 (the award is not public); *Cargill, Incorporated v. United Mexican States*, Award (18 September 2009), ICSID Case No. ARB(AF)/05/2.

69 *Archer Daniels Midland* supra n. 68, paras 212, 225-226.

70 L. Carroll (2023). What Place Does an Umbrella Clause Have in the New Generation of Bilateral Investment Treaties?. 40 *Journal of International Arbitration* 2, p. 126.

71 E.g. *Compañía de Aguas del Aconquija SA and Vivendi Universal (formerly Compagnie Générale des Eaux) v. Argentine Republic*, ICSID Case No. ARB/97/3, Decision on Annulment (3 July 2002), paras 95, 96.

72 S. van Weeghel (2022). Tax and Investment Treaties: Further Thoughts in P. Pistone (ed.). *Building Global International Tax Law: Essays in Honour of Guglielmo Maisto*. IBFD, sec. 26.2.5.

73 Ibidem. See also: P.H.M. Simonis (2014). BITs and Taxes. 42 *Intertax* 4, p. 275.

74 See *Consutel Group SpA in liquidazione v. People's Democratic Republic of Algeria*, PCA No. 2017-33, Award (3 Feb. 2020), para. 325. See more in J. Chaisse (2022). Consutel Group SpA in liquidazione v. People's Democratic Republic of Algeria: Umbrella Clauses and Breaches of Contract by Public Entities. 37 *ICSID Review* 3, pp. 643-644.

may always protect investments against such measures.

Although there are more standards of investment treaty protection,[75] they are of much less practical importance for tax-related ISDS claims than those four crisply discussed above. Focusing on those four standards by tax policy-makers is of paramount importance for reducing risks of investments within the ambit of state's fiscal power. Neglecting or outrightly ignoring those standards while shaping tax policy may lead in the views of arbitral tribunals to abuse rather than use of a state's fiscal powers, leading to violation of international obligations under IIAs. We will discuss examples of such cases in Part Two of the article (forthcoming issue of the BRITJ). Before doing so, we zoom in on the so-called tax carve-outs and tax measures in good faith (*bona fide*) by contrast to those in bad faith (*mala fide*). This is important to precisely delineate the scope of the impact of IIAs on tax policy.

3.3 Tax Carve-outs and *bona fide* Tax Measures

The standards of investment treaty protection cover tax measures, unless they are carved out from IIAs. The UNCTAD research shows that only around 1% of all IIAs do not contain any tax carve-out.[76] The vast majority of IIAs — 83% — includes partial carve-outs for tax measures. The narrowest and the most common exclude the benefits under DTTs from the scope of the MFN clause. The most important tax carve-outs in practice, albeit less widespread, are those concerning NT, FET and expropriation provisions. Even if there are tax carve-outs, IIAs often contain an exception to the carve-out in the form of a "claw-back", typically in respect of the expropriation clauses.[77] Only 16% of all IIAs, typically the most recent, fully carve out all tax measures from their scope.[78] Accordingly, UNCTAD concludes that despite the fact that almost all recent IIAs contain some type of carve-out (99%), most tax measures are still within the scope of one or more standards of investment treaty protections. In fact, the vast majority of old-generation IIAs, which constitute nearly 90% of IIAs that are currently in force, do not provide for tax carve-outs that are relevant to tax measures in respect of all investment treaty protection standards.[79] In particular, in 2017 it was reported that the most frequent carve-outs do not exclude the widest and thus the most important investment protection standard — the FET.[80]

Furthermore, the arbitral tribunal in the *Yukos* case developed the doctrine according to which tax carve-outs apply only to a *bona fide* (good faith) tax measure,[81] i.e. where "(i) there is a law (ii) that imposes a liability on classes of persons (iii) to pay money to the State (iv) for public purposes."[82] A tax measure is *bona fide* only if it meets all four criteria cumulatively. In practice, a tax measure is usually not *bona fide* because of failing the criteria (iii) and (iv) or only (iv). For instance, in the *Yukos* case, the tribunal observed that "the carve-out of Article 21(1) can apply only to *bona fide* taxation actions, i.e. actions that are motivated by the purpose of

75 E.g. full protection and security, most-favoured nation, and free transfer of profits.

76 UNCTAD supra n. 5, p. 4.

77 These exceptions from tax carve-outs are also known as Matryoshka clauses. Typical example of such clause is Art. 21 of the Energy Charter Treaty (adopted on 17 December 1994; entered into force on 16 April 1998).

78 Ibidem, p. 5.

79 Ibidem, p. 5.

80 P. Pistone (2017). General Report in M. Lang et al. (eds.). *The Impact of Bilateral Investment Treaties on Taxation*. IBFD, sec. 1.3.2.

81 *Yukos* supra n. 37, para. 1407.

82 *Burlington Resources, Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Jurisdiction (2 June 2010), para. 165.

raising general revenue for the State. By contrast, actions that are taken only under the guise of taxation, but in reality aim to achieve an entirely unrelated purpose (such as the destruction of a company or the elimination of a political opponent) cannot qualify for exemption from the protection standards of the ECT under the taxation carve-out in Article 21(1)."[83] (emphasis added)

The tax measures in *Yukos* case were expropriatory in nature, leading to a destruction of the investment. The primary objective of such measures was not to collect taxes for public purposes but to bankrupt *Yukos* and all of its assets.[84] Such tax measures are clearly not *bona fide*. This shows that expropriatory tax measures cannot be seen as *bona fide* in general because they eliminate the source of income (the investment), and without that source, income on which taxes are collected disappears.[85] Such tax measures are contradictory to the two or one of four cumulative criteria of a tax measure in good faith, i.e. to both (iii) paying money to the state (iv) for public purposes or only the latter. That is to say, even if in a short term an imposition of *mala fide* tax leads to paying money to the government, thus the criterion (iii) above is met, it does not serve a public purpose, thus the criterion (iv) above is not met. Moreover, in a medium and long term, the criterion (iii) above is not met either because the income on which taxes are imposed and the source of income from which money are paid to the government vanish.

We extrapolate similar observations from the *Horthel v. Poland* case, although a tax measure in that case was not considered by the arbitral tribunal as expropriatory because the "Polish subsidiaries in fact continued to operate a number of [gambling] machines for a profit until the expiry of the respective permits".[86] Still, the arbitral tribunal pointed out that a drastic increase in taxation of profits of companies within the gambling sector in Poland "was a taxation measure on its face", while in reality it led to the exit of that business from the host state, making it economically unviable. This was in contravention of the investor's legitimate expectations "under the permits to operate pursuant to the permits' terms for the duration of their terms in contravention", which violated the FET standard.[87] Such a tax measure "would not result in an increase of budgetary revenues, since the tax would cause a large number of permitted machines to stop operating".[88] Thus, although the tribunal did not call the examined Polish tax measures explicitly as being *bad faith*, it seems to blend an analysis of bad faith tax measures with an analysis of whether a measure is a tax at all.[89] Indeed, the tribunal observed that the tax measure "was not in fact aimed at increasing the state's revenues",[90] which implies that it was not a tax measure, or it was a tax measure in bad faith. The result for a tax carve-out for such a measure would be the same: the lack of its applicability.

There is also an important relationship between a tax carve-out and an umbrella clause, if

83 *Yukos* supra n. 37, para. 1407.

84 *Yukos* supra n. 37, para. 756.

85 In that regard, one may refer to the observation of Adam Smith: "A tax which tended to drive away stock from any particular country would so far tend to dry up every source of revenue both to the sovereign and to the society. Not only the profits of stock, but the rent of land and the wages of labour would necessarily be more or less diminished by its removal." See A. Smith. *An Inquiry into the Nature and Causes of the Wealth of Nations, Book V, Chapter 2, Article II*, https://www.adamsmithworks.org/documents/wealth-of-nations-reading-guide-book-v-chapter-2.

86 *Horthel* supra n. 63, paras 208-210.

87 *Horthel* supra n. 63, paras 256-259.

88 *Horthel* supra n. 63, para. 256.

89 F. Balcerzak (2023). Horthel v. Poland: Fair and Equitable Treatment Embodies the Rule of Law, Whereas 'Tax' Is Not Always a Tax. 38 *ICSID Rev-FILJ* 1, p. 36.

90 *Horthel* supra n. 63, para. 257.

they are both included in an IIA: the umbrella clause appears as a recapture clause to the tax measure to the extent to which it covers such measure. In other words, the umbrella clause recaptures a tax measure under the IIA's protection in spite of their exclusion by a tax carve-out in the remaining scope.[91] For example, Art. 2(6) of the Poland-US BIT (1990) includes a broad umbrella clause: "Each Party shall observe any obligation it may have entered into with regard to investments."[92] The tax carve-out in Art. 6(2)(c) of the Poland-US BIT (1990) does not apply to "the observance and enforcement of terms of an investment agreement". Accordingly, this umbrella clause brings under the Poland-US BIT's protection the host state's commitments made in a contract with an investor, which includes a tax stabilization agreement and granting preferential tax rates or tax holidays under the state's obligation toward investors to do so.

Tax policymakers can benefit from the consultation with tax and investment treaty experts on the complex operation of tax carve-outs. As the above analysis shows, their application is by no means straightforward. Moreover, their additions or modifications to current or new IIAs should be weighted against narrowing down the investment treaty protection toward tax measures. If they are too broad, a host state sends a signal to foreign investors that they may not be provided with fair and equitable tax treatment. In extreme situations, it means that investors may even fear of being illegally expropriated via *mala fide* tax measures. This certainly increases the risks and thus costs of investments on the territory of the host state.

(To be continued)

91 See *Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v. Mongolia*, UNCITRAL, Award on Jurisdiction and Liability (28 April 2011), para. 370. See also Weeghel, supra n. 72, sec. 26.2.5. Cf. Salacuse supra n. 11, pp. 366-367.

92 For a broad understanding of that umbrella clause see *Eureko B.V. v. Republic of Poland*, Partial Award (19 August 2005), para. 246.

Benefits of Coordinating Trade Regulation and International Tax Rules

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Abstract: With the increasing globalisation of production chains, the trade in intermediate goods and associated services is also constantly growing. Trade between related parties within multinational groups is increasing as a proportion of global trade, and there are growing levels of north/south trade. These factors are leading to changes in the approaches to international taxation and its interaction with global trading rules. The World Trade Organization (WTO) agreements have a potentially significant impact on cross-border tax relationships through concepts such as the non-discrimination principle; the agreement on subsidies and countervailing measures; and the most favoured nation (MFN) principle. Governments will need to work together to ensure that global tax and trade policies are supportive of each other. There will also be a need for capacity building in Belt and Road Initiative jurisdictions to ensure that they can benefit from tax and trade rules. Countries must be more aware of the risks of tax protectionism, and work to maintain an open global trading system.

Keywords: International tax; Trade policy; BEPS global minimum tax; Globalisation; Production chains; Trade in services; Protectionism

1. Introduction

The regulation of international trade and the coordination of international tax rules have for a long time occupied different areas of international relations. The interaction of international trade and tax rules has not been the subject of much analysis, and practitioners in one area have generally not been very much involved in the other. Global trade policy has focused generally on reducing obstacles to trade, while international tax policy has had the more limited objective of avoiding double taxation.

Taxation is seen as a core attribute of sovereignty, with countries claiming the right to tax the income of their citizens wherever it is earned. By contrast, countries have increasingly accepted that it is beneficial to give up their rights to apply

duties to goods or services in international trade, as the reduction of tariff barriers to international trade is a win-win situation for all countries. Trade policy has generally been pursued at the multilateral, regional and bilateral levels, while taxation agreements have generally been at a bilateral level, for example double taxation agreements.

Both taxation and trade are areas that have an impact on external economic policy making. In the present circumstances of stressed public finances in many countries, including jurisdictions involved in the Belt and Road Initiative (BRI) projects, and with the heightened interest in the international coordination of tax rules, countries should be concerned with the interaction of trade and tax rules. BRI jurisdictions need to achieve a balance between establishing a favourable climate for investment and continuing to increase domestic resource mobilisation through tax measures.

The OECD/G20 Project on Base Erosion and Profit Shifting (BEPS) addresses risks to tax bases from cross-border activities; and the proposed two-pillar approach to international taxation has included the global minimum tax provisions. These developments highlight the need for a greater understanding of trade rules as they relate to tax. With the possibility of more multinationals operating in their territory, BRI jurisdictions may need to assess the benefit of applying the global minimum tax, with a domestic minimum top-up tax to ensure that any top-up tax paid by the multinationals is collected by the national exchequer and not paid to foreign jurisdictions.

The introduction by many jurisdictions of the global minimum tax rules is likely to influence wider tax policies, with many developing countries reviewing their tax incentives. This is also likely to affect the incentive strategy of BRI jurisdictions involved. The nature of tax incentives may shift from direct tax exemptions to tax relief based on expenditure; indirect tax incentives; or non-tax measures to attract investment. The result may be greater interaction of tax and trade rules, leading to a more urgent need to look at dispute resolution mechanisms.

2. Growing Interaction of Tax and Trade Regimes

2.1 Overview and Factors Driving Change

The limited interaction between tax and trade rules is changing under the influence of several factors. The most important factor has been the globalisation of production chains, where fragmented and "unbundled" production processes have resulted in growing trade of intermediate goods and associated services. The average import content of exports has grown, for example, and this fragmentation of global trade has opened new opportunities for multinational groups to optimise corporate income tax.

The issue of taxation of multinational groups with global supply chains has led to an increased focus on the use of interest deductions, royalties paid for intellectual property, service charges, management fees and technical fees between related companies. This often gives rise to the general perception that multinationals are using transfer mispricing to reduce tax liabilities and engage in abusive tax practices. There are also increasing complexities in trade patterns due to the degree of specialisation being achieved in global supply chains. These challenges need to be borne in mind by jurisdictions involved in BRI projects.

The focus in international tax has, in many cases, moved from avoiding double taxation to determining whether the tax rules facilitate double non-taxation. The issue of fairness has also become more prominent as the world economy rebalances, with the value of tax competition between jurisdictions being increasingly questioned.

These factors are leading to changes in the approaches to taxation, which have become more urgent with globalisation. A different international tax regime is being driven by multilateral initiatives, such as the BEPS project; unilateral measures, such as digital services taxes; and regional measures, such as the EU Commission actions under competition/state aid rules.

In addition to the policy issues mentioned above, the increasing interaction between these areas now require some capacity rebalanc-

ing within tax administration bodies in BRI jurisdictions. Transfer pricing issues increase in complexity as intermediate goods circulate across border between related parties and also formally unrelated but economically dependent firms. This necessitates the updating of transfer pricing rules and the capacity to identify potential risks to revenue. This issue is further aggravated in such transactions within a regional economic grouping or preferential trading arrangement where countries have a common trade framework but different domestic tax rules.

2.2 Impact of Regional Groupings

Tax and trade regimes also increasingly interact in the context of regional economic groupings in two different ways. The first is that such groupings usually require lowering of trade and trade tax barriers between regional partners. There is consequently an impact on overall national revenue. The Association of Southeast Asian Nations (ASEAN) Free Trade Area (AFTA) has led to a decline in customs revenue for ASEAN countries due to the reduction or elimination of tariffs on intra-ASEAN trade. For example, Thailand's Customs Department expects a revenue decline of THB3-4 billion (US$90-120 million) as a result of AFTA tariff cuts.[1] While reductions in tariffs have facilitated increased trade among ASEAN member countries, they have also resulted in lower customs revenue from import and export duties.[2]

Trade tax revenue in Mercosur countries (Brazil, Argentina, Paraguay, and Uruguay) has declined due to preferential trade agreements, such as the one with the European Union.[3] The reduction in tariffs boosts trade and investment flows; however, these agreements also result in member countries collecting less revenue from import duties. This decline forces governments to look for alternative sources of income to compensate for the loss. There is thus increasing pressure to find revenue from the VAT/GST or direct taxes or look for selective taxes to compensate for the loss.

A second area of interaction within regional groupings has been the consideration of tax advantages or incentives given as trade subsidies that need to be recaptured. The European Commission decisions that selective tax advantages (for *Fiat* in Luxembourg and *Starbucks* in the Netherlands)[4] constituted illegal state aid is a very clear reminder of such interaction. A more emphatic ruling was in the case of *Apple*.[5] In September 2024, the European Court of Justice set aside the General Court's judgment and confirmed the European Commission's decision about state aid. The Court ruled that Ireland had indeed granted unlawful state aid to Apple, and the company was required to pay EUR13 billion in unpaid taxes.

2.3 WTO Rulings

There have been some instances of direct interaction between the tax and trade rules, when taxes have been used to distort trade. The World Trade Organization (WTO) Panel

1 *Thailand to Lose Bt3-4 Billion Revenue from Afta Tariff Cuts,* https://aseannow.com/topic/330060-thailand-to-lose-bt3-4-billion-revenue-from-afta-tariff-cuts/?form=MG0AV3&form=MG0AV3.

2 Hector Calvo-Pardo, Caroline Freund & Emanuel Ornelas. *The ASEAN Free Trade Agreement Impact on Trade Flows and External Trade Barriers*, World Bank Policy Research Working Paper 4960, Washington DC.

3 *What Are Implications EU Mercosur Free Trade Agreement?* https://www.csis.org/analysis/what-are-implications-eu-mercosur-free-trade-agreement?form=MG0AV3.

4 European Commission (2015). *Commission Decides Selective Tax Advantages for Fiat in Luxembourg and Starbucks in the Netherlands Are Illegal under EU State Aid Rules*, http://europa.eu/rapid/press-release_IP-15-5880_en.htm.

5 Court of Justice of the European Union (2024). *Tax Rulings: The Court of Justice Sets aside the Judgment of the General Court Concerning Tax Rulings Issued by Ireland in Favour of Apple*, https://curia.europa.eu/jcms/upload/docs/application/pdf/2024-09/cp240133en.pdf?form=MG0AV3&form=MG0AV3.

rulings on alcohol excises in Chile[6], Korea[7] and Japan[8] are some examples of the impact of international trade rules on taxes. The general view was that the definition of "internal taxes" in the General Agreement on Tariffs and Trade (GATT) covered indirect taxes such as sales tax, excises and VAT. However, the rulings on the US Foreign Sales Corporation (FSC) and Extraterritorial Income Exclusion (ETI) regimes, on the provision of the equivalent to an export subsidy, significantly modified this view.[9] A further significant case is the ruling of the WTO Panel on Argentina's "blacklist" of uncooperative jurisdictions, which relates entirely to direct taxes and some other non-tax measures.[10]

An unintended consequence of these decisions has been to result in the WTO dispute settlement processes being considered by some as an alternative forum for settlement of tax disputes. While not formally contemplated as such, in the absence of binding arbitration or other forum for dispute resolution, countries unwilling to go through mutual agreement proceedings may increasingly consider these bodies as alternative means of dispute resolution. While the Dispute Settlement Body (DSB) and the Appellate Body at the WTO are not functioning well due to political disagreements, it is possible to contemplate other organisations stepping in their place as a forum for disputes on taxation issues.

3. Trade Principles That Impact Tax Rules

The key trade provisions that affect tax rules can be found in the WTO Agreement which provides the institutional framework encompassing the GATT and around 15 other agreements on trade-related issues. The central rule is a general prohibition of measures that would result in discrimination of imported goods through the domestic tax system (National Treatment on Internal Taxation and Regulation, Article III).

The same principle is applied to services by the General Agreement on Trade in Services (GATS) Article XVII; and is applied to intellectual property by the Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS) Article 3, in a slightly different manner. These measures are supplemented by other provisions that generally aim to protect equal competitive opportunities for all member countries of the WTO.

The other provisions include the most favoured nation (MFN) principle under which products (or services/IP) from one WTO member cannot be treated less favourably than products (or services/IP) from another WTO member. The MFN principle applies to tariffs and all internal trade-related rules, and it also applies to other forms of indirect taxation. Although the growth of regional trading blocs with their own systems of preferential tariffs has reduced the percentage of trade subject to the MFN principle, studies have shown that the majority of cross-border trade is still carried out on MFN terms.[11] A recent study indicates that all the top 20 trading economies conduct the majority of their imports under the MFN principle, and the principle is still an important pillar of the global trading system.[12]

6 AB Report/Panel Report Chile – Taxes on Alcoholic Beverages WT/DS87.

7 AB Report/Panel Report Korea – Taxes on Alcoholic Beverages, WT/DS75/AB/R, WT/DS84/AB/R.

8 Panel on Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages, L/6216, 1987, BISD 34S/83; AB Report/Panel Report Japan – Alcoholic Beverages II WT/DS8, WT/DS9 and WT/DS11.

9 Panel Report United States – Tax Treatment for Foreign Sales Corporations, WT/DS108/R.

10 DS453 Argentina – Measures Relating to Trade in Goods and Services, 30 September 2015.

11 R. Acharya & T. Parajuli. *WTO Working Paper: The Evolution of Preferential Trade under Regional Trade Agreements: Has Anything Changed?* https://www.wto.org/english/res_e/reser_e/ersd202503_e.pdf .

12 T Gonciarz & T Verbeet. *WTO Working Paper: Significance of Most-Favoured Nation Terms in Global Trade: A Comprehensive Analysis*, https://www.wto.org/english/res_e/reser_e/ersd202502_e.pdf.

Another important provision is the Subsidies and Countervailing Measures (SCM) agreement. This prevents the use of tax measures to support domestic industries. The SCM agreement allows a domestic tax measure to be challenged, provided the complainant can establish that the challenged provision constitutes a subsidy within the meaning of the SCM agreement.

The agreements are based on a principle of transparency. This means that all rules and regulations must be published and made publicly available. There must not be any secret rules providing for de facto discrimination.

An important part of the negotiation process for the GATS agreement on services was the tax carve out which excluded direct tax issues from the national treatment (NT) obligations under GATS Article XVII. NT obligations in GATS remain applicable for indirect taxes. This provision is important in relation to the fragmentation of supply chains, where manufacturing can be done entirely by contractors, and a multinational manufacturing enterprise could be deriving most of its revenues from providing services to a national subsidiary which contracts out most of its manufacturing to third parties.

4. Tax Issues Arising from Trade Provisions

4.1 Non-discrimination Principle

Some concepts in the WTO agreements have a potentially significant impact on cross-border tax relationships between countries. An early panel decision indicated that measures affecting an internal sale under the NT principle covered not only laws and regulations directly governing the conditions of sale or purchase, but also covered rules that might adversely modify the conditions of competition between domestic and imported goods on the internal market.[13] This broad definition could cover certain tax measures, for example direct tax depreciation rules that might favour domestically-produced equipment.

4.2 Subsidies and Countervailing Measures

The SCM agreement defines a subsidy as a financial contribution granted by a government or any form of income or price support through which a benefit is conferred. A "financial contribution" has been interpreted to include government revenue that is foregone or not collected, even though it should otherwise be due. "Benefit conferred" means that the beneficiary of the measure been placed in a better position.[14] Therefore government policies, including tax, investment and expenditure policies, could be a subsidy under this definition. The SCM agreement explicitly refers to subsidies in the form of tax measures. Tax incentives in the form of indirect tax concessions or income tax exemptions, accelerated depreciation, reduced tax rates or tax credits, may fall within the ambit of the SCM agreement.

4.3 Most Favoured Nation Principle

The MFN obligation refers to "any advantage, favour, privilege or immunity granted" and the obligation is to "accord immediately and unconditionally" such privileges to all other contracting parties. A panel has ruled that "the most favoured nation treatment principle embodied in that paragraph would be applicable to any advantage, favour, privilege or immunity granted with respect to internal taxes".[15] The Argentina/Panama ruling mentioned earlier, by bringing in the application of the broad MFN obligation to a list of uncooperative jurisdictions for tax purposes, raises questions about the ability of countries to apply controlled foreign companies (CFC) rules and anti-treaty shopping provisions.

Similar principles of providing equal competitive opportunities are reflected in the EC

13 Panel Report on Italian Discrimination Against Imported Agricultural Machinery, L/833, 1958, BISD 7S/60.

14 AB Report Canada – Measures Affecting the Export of Civilian Aircraft, WT/DS70/AB/R, 1999.

15 GATT Panel Report, Belgian Family Allowances, G/32, adopted 7 November 1952, BISD 1S/59.

Treaty article on the prevention of state aid within the EU. These principles, while differing somewhat from the obligations under SCM, are of direct relevance to EU member states. The EC Treaty has, over time, had significant influence over the direct tax systems of its member states, through provisions such as the state aid rules or the freedom of movement of persons or capital.

4.4 EU State Aid Rules

In December 2014, the European Commission asked all member states to provide information about their tax ruling practices to see if they were creating competitive distortions by providing state aid through tax benefits. The scope of "tax benefits" can be significant; it could include, for example, tax expenditures, exclusion of taxable income, tax deferrals and even cancellation of tax debts.

Challenges by the European Commission to tax measures, based on the State Aid rules, have led to the hearing of appeals by the European Court of Justice in relation to tax rulings granted by Ireland (Apple), Luxembourg (Amazon and Fiat), the Netherlands (Starbucks) and a Belgian corporate income tax scheme. Although the European Commission is not always successful in demonstrating that State Aid provisions have been violated, it has had numerous successes in cases involving tax rulings.

5. Global Minimum Tax and the Future of Tax Incentives

Pillar Two of the OECD/G20 two-pillar proposal for international tax sets out a minimum effective tax rate that should have the effect of limiting tax competition and stopping a "race to the bottom" on tax rates. The global minimum tax will reduce the incentives for multinational companies to engage in profit shifting and will help countries to achieve a balance between using tax policy to attract investment and mobilising domestic revenues. Countries may benefit from using fewer direct tax holidays and reliefs, and switching to tax incentives based on expenditure, indirect tax relief or non-tax incentives.

Although countries can continue to use the tax system to attract investment, the global minimum tax will discourage the use of direct tax incentives. If corporate income tax incentives are poorly designed, they can be of limited usefulness, while resulting in substantial tax revenue losses. The additional revenues generated by the application of the global minimum tax can support economic development or help countries to improve their investment environment. These non-tax factors are valued by investors and will become increasingly important after the introduction of the global minimum tax, as jurisdictions try to improve their competitiveness by looking at policies beyond tax.

Jurisdictions involved in BRI projects should be conducting a thorough assessment of the tax incentives currently in place. Tax incentive reform will be especially important for developing and emerging economies. In some countries, reform of tax incentives may be challenging to implement, due to the complex governance of tax incentives involving different laws and government agencies. Countries will also need to consider stabilisation clauses in contracts and obligations, which may result from certain investment agreements.

BRI jurisdictions should also be looking at the introduction of a qualified domestic minimum top-up tax (QDMTT) to ensure that they can apply a domestic top-up tax to low-taxed income arising domestically before that income is subject to top-up taxes imposed by other jurisdictions. The impact on competitiveness will be limited, as the income would otherwise be taxed by other jurisdictions. Following the introduction of a domestic top-up tax there will still be a case for tax incentive reform, as some direct tax incentives previously introduced may become ineffective.

As the implementation of the global minimum tax draws closer, BRI jurisdictions should be cautious when considering implementing new tax incentives; or entering into new investment contracts. Jurisdictions should examine which taxpayers are benefitting from different incentives, and how different taxpayers and tax incentives will be affected by the minimum tax.

Direct tax incentives can still provide benefits for firms that are not within the scope of the global minimum tax, such as domestic firms or subsidiaries of multinational groups with revenues below EUR750 million.

BRI jurisdictions should therefore examine the extent of their need to change the types of incentives offered. On the one hand, participation in BRI projects may increase the number of multinationals operating in their territory. On the other hand, firms with economic substance in a jurisdiction will be less affected by the minimum tax than other taxpayers, as they will benefit from the substance-based income exclusion (SBIE) and therefore face a smaller exposure to the global minimum tax.

Expenditure-based tax incentives that target payroll or tangible assets may be less affected than income-based tax incentives. Such provisions require expenditures that are part of the SBIE, which excludes a share of profits from top-up taxes based on the level of economic substance. Also, tax incentives that allow the faster recovery of the cost of tangible assets will be unaffected by the minimum tax provisions. These incentives include immediate expensing or accelerated depreciation for investment in tangible assets. They may be valuable for multinationals beginning their participation in projects within BRI jurisdictions.

The global minimum tax rules follow financial accounting rules in treating cash grants and refundable tax credits as income, so these types of incentives are less likely to be affected by the minimum tax. Jurisdictions should however exercise caution with these incentives due to their potentially significant fiscal impact for developing countries.

BRI jurisdictions should look at the interaction of various tax incentives, as it is often the accumulation of tax incentives that can give rise to a low ETR. Reforms will be a priority in jurisdictions that rely on income-based tax incentives with few associated conditions and where the incentives are associated with little tangible investment or employment but significant profits. Developing countries frequently rely on income-based incentives such as tax holidays and should therefore look at possible reforms. The urgency of the task will depend partly on the number of multinationals with revenue above EUR750 million, but for in-scope multinationals, jurisdictions may consider shifting from income-based to expenditure-based tax incentives; or consider introducing or increasing the stringency of tangible asset investment or employment requirements.

A greater use of expenditure-based than income-based tax incentives is likely to result from the changes, with better targeting of tax incentives to activities that strengthen the link between tax incentives and substance in the jurisdiction. BRI jurisdictions should also look more closely at offering incentives in relation to indirect tax and customs duties or offering non-tax incentives.

If there is a greater emphasis on indirect tax incentives, including VAT, excise and customs duty relief, there is a possibility that trade disputes could arise from these measures, for example where legislation changes during the course of a contract. The effect of tax changes on existing contracts should therefore be examined to assess the likelihood that they could be challenged by investors.

6. Impact of Digitalisation

6.1 Spread of Digitalisation

The advances in information and telecommunication technologies taking place in recent decades have significantly impacted the methods by which goods, services, and information are bought and sold.[16] New electronic and digital markets have been created, with large amounts of goods and services sold through digital platforms. Consequently, cross-border trade is increasingly digital in nature, and this trend is

16 WTO (2024). *The Long-Run Impact of Digitalisation on Trade Patterns*, https://www.wto.org/english/res_e/reser_e/ersd202501_e.pdf.

growing all the time. Also, industries worldwide are increasingly using robotic technology. In recent years there has been significant progress in the development of artificial intelligence (AI) systems with the use of large language models. This indicates that there is a new stage in the deployment and use of AI, adding to the potential advantages of digitalisation.

The new technologies and increasing digitalisation could influence international trade in the longer term. The adoption of artificial intelligence will have an impact on productivity growth; the reduction of trade costs through digitalisation; a greater shift to online sales; reduced need for physical interaction; and changes in data policies resulting from the use of new technologies, also impacting trade costs.

Digitalisation is likely to provide a strong boost to global trade growth and a shift from merchandise trade towards services, particularly digitally deliverable services (DDS). Greater digitalisation can offer an opportunity for low-income and lower-middle-income economies, including jurisdictions involved in BRI projects, to increase their share in global trade and income. These economies could especially benefit from the trade growth in DDS.

It is therefore important for low-income and middle-income economies to adopt digital technology. Jurisdictions involved in BRI projects could benefit from greater adoption of the technology. Policy to promote digitalisation should involve a combination of infrastructure provision; the establishment of a predictable regulatory environment; and investments in education and training to create a digitally knowledgeable workforce. It is likely that the adoption of digital technology could reduce trade costs in the longer term.

6.2 Trade Conflict Arising from Digitalisation

Digitalisation could give rise to new areas of conflict related to cross-border data flows, issues around privacy and confidentiality and differences in national regulations. Without comprehensive international standards on data governance, there could be trade disputes

between countries arising from their need to collect information and enforce data governance while maintaining the flow of trade. The need for data collection affects the tax administration and customs authorities which need accurate data to allow them to impose correct tax and tariffs. The possible increase in the imposition of digital services taxes, especially if countries do not adopt the Pillar One rules on taxation of large multinationals, could increase disputes as more trade in goods and services goes online.

This issue has now been brought to the fore through the actions of the Trump administration in the USA. The government has recently taken several actions against countries that have implemented Digital Services Taxes (DSTs), which they viewed as unfairly targeting American tech companies. The administration has, under this initiative, ordered investigations into DSTs imposed by countries like Austria, Spain, Italy, France, Canada, and India. These investigations are aimed to determine if the DSTs were discriminatory against US

companies.[17]

In February 2025, President Trump issued a memorandum directing the US Trade Representative to renew DST investigations and consider responsive actions, such as tariffs, against countries that imposed DSTs.[18] In taking these steps, the administration's stated goal was to protect American companies from what they considered "overseas extortion" and unfair taxation practices. They argued that DSTs undermined American economic and national security interests. While these actions were part of a broader effort to defend American companies and innovators from what the administration saw as unfair and anti-competitive practices by foreign governments, the key point here is the use of trade mechanisms to combat a tax measure. This creates more of a precedent in using trade measures to change tax policy.

7. Benefits from Smoother Interaction of Tax and Trade Rules

It is reasonable to conclude that trade rules may have a significant impact on tax rules going forward, but it is also necessary to consider both global tax and trade rules in their broader context. The trade rules written decades ago by a smaller group of nations need to remain viable in the current much more complex world. There is now a much greater, and growing, value of trade in services as compared with goods; an increasing share of global trade between related parties within multinational groups; and greater north/south trade that is growing faster than in-

17 Sierra Marlee. *America First! New Trump Order will End 'Overseas Extortion'*, https://www.bizpacreview.com/2025/02/22/america-first-new-trump-order-will-end-overseas-extortion-1524575/?form=MG0AV3.

18 White House (2025). *Fact Sheet: President Donald J. Trump Issues Directive to Prevent the Unfair Exploitation of American Innovation*, https://www.whitehouse.gov/fact-sheets/2025/02/fact-sheet-president-donald-j-trump-issues-directive-to-prevent-the-unfair-exploitation-of-american-innovation/?form=MG0AV3.

tra-north trade.

There is greater complexity in trade and tax policy. In global trade, the requirements for health and safety standards, security controls, etc. are already the largest components in regulatory costs in trade. For example, where tariffs now constitute an average of 5% of cost in trade amongst countries, the costs associated with precautionary health, safety and security provisions can be as high as 20% of costs. It is very difficult for companies to standardise solutions and manage costs, as the standards are often set individually by countries.

The tax issues raised by digitalisation and e-commerce foreshadow the much more complex responses that will be needed to deal with digital manufactures and services. Challenges around tax evasion are likely to be further connected to surveillance for illicit flows of funds, anti-corruption efforts and the fight against drugs and terrorism. In other words, concerns regarding the integrity of global tax arrangements, and the need for information for security reasons, are likely to be considered a higher priority than the need to avoid double taxation. Many of these concerns were reflected in the work on the common reporting standard and the action plan on BEPS. These are very real concerns for many of the jurisdictions involved in BRI projects.

Global tax and trade policies need to remain supportive of each other. Although there are significant challenges, there are opportunities for coordination and to benefit from the lessons already learned. A possible area where the dialogue on international tax rules could benefit is to look at the well-established investigation and dispute settlement procedures within the WTO arrangements. There are lessons to be learned for the resolution of tax disputes, perhaps through bilateral agreement on the arbitration of tax disputes. It is important to note that in the US FSC/ETI case,[19] a trade tribunal was able to deliver binding rulings on an international tax issue, while there is no equivalent tax body with similar powers able to consider issues from an objective standpoint.

8. Conclusions and Recommendations

The interaction between trade and tax rules can bring benefits for both sets of rules. It may be possible to develop a common approach, for both tax and trade arrangements, to accurately identify where value is being created. While it is acceptable to impose tax in the location where value is created, the challenge is to identify and allocate the value between jurisdictions. Also, while fairness is a generally acceptable goal, agreeing on what is fair will continue to be a challenge.

Developing countries have genuine concerns about the extent of their knowledge of global supply chains, and a possible information deficit in relation to value addition by multinational enterprises. The developing economies, including jurisdictions involved in BRI projects, need to have increased confidence in the information being submitted. The scale of globalisation and increased compliance requirements also create challenges for multinational corporations.

Governments will need to continue to work to ensure that global tax and trade policies are supportive of each other; and continue to promote trade and investment in an open system.

There will be a need to build capacity in BRI jurisdictions, and to be aware of the risks of tax protectionism, where jurisdictions protect their tax base from the detriment of the principles of an open trading system.

The commonly acceptable principles of transparency, mandatory exchange of information, non-discrimination, predictability and stability continue to apply. Global trade rules should not move away from the principle of equal treatment and the goal of a fair and equitable trading system. A common approach can simplify efforts for trade regulation and the coordination of international tax rules. An open, transparent tax system, consistent with trade obligations, can be a nation's most important trade policy.

19 WTO | dispute settlement — the disputes — DS108.

Taxes and Death Alike: There Is No Easy Way Out*

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Abstract: The US' recent "withdrawal" from the Global Tax Deal could have led an observer to perform the autopsy of the most important international tax agreement of the decade. Yet Pascal Saint-Amans, former Director of the OECD's Centre for Tax Policy and Administration and Professor at HEC Paris, advises keeping obituaries in the pocket for the time being. The "Global Tax Deal", better known as the Two-Pillar Solution, was agreed by 137 jurisdictions at the Inclusive Framework in 2021, following 10 years of negotiations to address Base Erosion and Profit Shifting (BEPS) under G20 leadership. Because of the way it was conceived and considering countries' positions and interests, the Global Tax Deal appears to be here to stay. When the gaming table is the world itself, quitting the game does not mean it is over. It signals the start of a new round.

Keywords: Two-Pillar Solution; Taxes; International relations; International tax policy; Global Tax Deal

On his first day in office, US President Donald Trump published a memorandum announcing that the OECD's Global Tax Deal "has no force or effect in the United States".[1] In addition, he ordered the US Treasury Department to develop a report with options for "retaliatory measures" against countries that might enact measures that "disproportionately affect American companies". This report was due by Friday 21 March 2025 but has not been made public.

The tax statement drew a lot of attention due to its tone and potential implications. It was strongly worded

* This article reflects the personal opinion of the author.

1 The White House (2025). *The Organization for Economic Co-operation and Development (OECD) Global Tax Deal (Global Tax Deal)*, https://www.whitehouse.gov/presidential-actions/2025/01/the-organization-for-economic-co-operation-and-development-oecd-global-tax-deal-global-tax-deal/.

and foreshadowed the tensions which are now gripping international relations. After its release, some engaged in an autopsy of the Global Tax Deal, while others pronounced early obituary notices. Yet, more than two months later, the situation is best described by a word that may strike more fear in businesses and their tax departments than death itself: uncertainty.

Indeed, the memorandum has raised several questions among observers regarding the specific steps the Treasury Department might recommend. Businesses and policymakers are still awaiting further clarifications from the US administration in order to assess possible consequences. It remains largely unclear how the US will implement its new policy and what the scope of disputed measures is.

Yet this very lack of clarity indicates one thing: the current situation is much more complex than the US and its president would like it to be. When the gaming table is the world itself, quitting the game does not mean it is over. It signals the start of a new round. Players, pay attention.

1. Gathering Players Around the Table — The Global Tax Deal

The "Global Tax Deal" mentioned in the memorandum is called the Two-Pillar Solution agreed by 137 jurisdictions at the OECD in 2021, and more than 140 up to now.[2] This agreement follows 10 years of negotiations to address Base Erosion and Profit Shifting (BEPS) under the G20 leadership. The length and complexity of the process reflect the considerable challenges involved in reaching consensus among multiple jurisdictions with different tax systems and policy priorities.

The BEPS initiative was meant to fix an outdated international tax framework which was based on a brick-and-mortar economy and to realign the location of profit with the location of business activities. Before the work on BEPS, international taxation rules focused mainly to avoid double taxation through the establishment of Double Taxation Agreements (DTAs), following principles established in a report of the League of Nations published in 1928.[3] However, these principles are not fit for today's digital and globalised economy, where highly mobile assets like intellectual property generate substantial wealth and multinational companies can cherry-pick the jurisdiction they want to locate their profit in. The rules which in the 20th century avoided double taxation led to no taxation in the 21st century, pushing the G20 in 2008 following the Great Financial Crisis to crack down on tax havens.

The political push in 2008 culminated in the G20 mandating a report *Addressing Base Erosion and Profit Shifting* in February 2013,[4] which led to G20 countries adopting a 15-point Action Plan to address BEPS in September 2013.[5] Action 1 of the BEPS initiative concerns *Addressing the Tax Challenges of the Digital Economy* leading to the creation of the Two-Pillar Solution.[6]

The Global Tax Deal negotiations led

2 OECD (2023). *Outcome Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy — 11 July 2023*, https://www.oecd.org/en/about/news/announcements/2023/07/outcome-statement-on-the-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2023.html.

3 League of Nations (1928). *Double Taxation and Tax Evasion*. Geneva: League of Nations.

4 OECD (2013). *Addressing Base Erosion and Profit Shifting*, https://www.oecd.org/en/publications/addressing-base-erosion-and-profit-shifting_9789264192744-en.html.

5 OECD. *Base Erosion and Profit Shifting (BEPS)*, https://www.oecd.org/en/topics/base-erosion-and-profit-shifting-beps.html#beps-actions.

6 OECD (2014). *Addressing the Tax Challenges of the Digital Economy,* https://www.oecd.org/en/publications/addressing-the-tax-challenges-of-the-digital-economy_9789264218789-en.html.

under the Inclusive Framework on BEPS were concluded in October 2021,[7] with very different features, compared with the launch of the negotiations in 2017.

The so-called Pillar One seeks to address *where* the largest multinational companies pay tax in a digital age. Pillar One is built of two parts, Amount A and Amount B.

Amount A seeks to address the growing frustration, particularly among European countries, over the fact that some firms, especially global tech giants, are able to create value and generate sales in various European jurisdictions but pay no tax there. Amount A provides jurisdictions in which consumers and users are located a new taxing right on multinational enterprises' (MNEs') revenues exceeding EUR20 billion and a profitability greater than 10%.

Amount B aims for a simplified and streamlined approach to transfer pricing (rules that provide for how intra-company transactions should be priced) to marketing and distribution activities.

While the technical negotiation has well advanced, prospects for conclusions were and remain very low as Pillar One Amount A would necessitate a Multilateral Convention, requiring ratification by two thirds of the US Senate and there has been no consensus by countries on Amount B. Negotiations went on mostly for the sake of preventing countries to take unilateral actions, such as digital services taxes (DSTs), which several countries including the UK, France, Italy and others still introduced in the course of negotiation to increase pressure on the US to reach the deal on Pillar One. The introduction of DSTs has illustrated the challenges faced by countries seeking short-term solutions pending a broader international agreement.

President Trump strongly opposed these unilateral measures in his first administration, with trade sanctions under "Section 301" of the Trade Act, first hitting France with a 25% tariff on some luxury items in response to their 3% DST and launched investigations against several other countries such as Austria, India, Spain, Turkey and the UK. The Biden administration suspended the sanctions until the end of the negotiation and in October 2021 a "Joint Statement from the United States, Austria, France, Italy, Spain, and the United Kingdom, Regarding a Compromise on a Transitional Approach to Existing Unilateral Measures During the Interim Period Before Pillar 1 Is in Effect" was published, under which European countries agreed to withdraw their DSTs and commit to retrieving the collected money under the DST as soon as Pillar One was implemented.

Pillar Two aims to establish *how much* companies are taxed by imposing a global minimum tax rate of 15% on MNEs with a global turnover of at least EUR750 million. It aims to reduce harmful tax competition between jurisdictions by limiting incentives for profit shifting. The tax will be implemented through a mechanism based on three interlocking rules, ensuring whenever the effective tax rate in a jurisdiction is below 15% that a top-up tax collects the difference between the effective tax rate and the 15%.

First, the low-taxed jurisdiction where the constituent entity of the MNE is located has the primary right to collect the top-up tax through a Qualified Domestic Minimum Top-up Tax (QDMTT). Second, if the low-taxed jurisdiction does not collect the tax, other jurisdictions where the parent company is located can collect the tax through the so-called Income Inclusion Rule (IIR). Finally, where a Qualified IIR does not apply, the top-up tax can be collected by any other jurisdiction implementing the Global Minimum Tax where a constituent entity of

7 OECD (2021). *International Community Strikes a Ground-Breaking Tax Deal for the Digital Age*, https://web-archive.oecd.org/2021-10-20/612898-international-community-strikes-a-ground-breaking-tax-deal-for-the-digital-age.htm.

the MNE is located through the so-called Undertaxed Profits Rule (UTPR). Under these measures, a country would be able to increase taxes on a business that pays less than 15% effective tax in another jurisdiction. These interlocking mechanisms collectively seek to ensure that no profits remain untaxed or taxed at excessively low rates. By doing so, Pillar Two neutralises tax credits and other benefits provided by jurisdictions whose statutory tax rate is above 15%, but whose effective tax rate is brought below 15% through aggressive tax benefits.

However, tax benefits incentivising the creation of tangible assets are shielded by Pillar Two through a so-called "substance-based carve-out" which allows to reduce the tax base on which the Global Minimum Tax is applied. The reduction is linked to payroll costs and eligible tangible assets as these factors are generally considered less mobile and less likely to lead to distortions.

Pillar Two draws on the US Global Minimum Tax (Global Intangible Low-Taxed Income, GILTI) introduced by the 2017 Tax Cuts and Jobs Act, which aimed to finance tax cuts by broadening the corporate income tax base. GILTI provides for a lower minimum tax applied on profits of multinational companies if their effective tax rate outside the US is on average below 10.5%. The Trump administration did not object other countries to adopt a minimum tax if US companies would be sheltered, because subject to GILTI. The Biden administration altered the solution by raising the rate to 15%, computing the effective tax rate on a country-by-country basis (instead of global average) and agreeing that American companies would not be sheltered by GILTI. President Biden failed to introduce the new Global Minimum Tax in the Inflation Reduction Act.

2. Quitting the Game — "The Global Tax Deal Has No Force or Effect in the United States"

President Trump's memorandum is built on two sections. Section 1 refers the "Applicability of the Global Tax Deal", while Section 2 covers the "Options for Protection from Discriminatory and Extraterritorial Tax Measures".

There are three main messages from the memorandum.

First, the aggressive tone of the memorandum sends a strong message that the US will not compromise. It sends a message to US businesses and US Congress: "any commitments made by the prior administration on behalf of the United States with respect to the Global Tax Deal have no force or effect within the United States absent an act by the Congress adopting the relevant provisions of the Global Tax Deal". This is no new news, as it is well known that any provisions related to international taxation need to be ratified by the US Congress. Similar messages were sent in the past, for instance when George W. Bush was elected in 2000 and stopped the work on harmful tax competition at the OECD. Still, unlike with the Paris Agreement or the WHO, President Trump has not announced that the US would leave the International Framework on BEPS. It is likely that the US will remain at the table, but with very firm positions.

Second, the US will resume its trade sanctions against countries implementing DST. The memorandum states that the Secretary of the Treasury "shall investigate whether any foreign countries are not in compliance with any tax treaty with the United States or have any tax rules in place, or are likely to put tax rules in place, that are extraterritorial or disproportionately affect American companies". This means that countries with DSTs are likely to be impacted by trade sanctions under Section 301. It is unclear how countries with DSTs will react as they have to choose between revenue, political messaging (taxing the tech giants is still popular policy) and trade sanctions. Recently, Chancellor Rachel Reeves suggested that the UK's 2% levy, introduced in 2020 and which raises about GBP800 million a year, could be altered in exchange for the US not imposing more im-

port taxes on the UK.[8] For countries, which had not implemented DSTs waiting for Pillar One to be concluded, it is unclear what their position will be, noting that many of them, tired of the inconclusive OECD negotiations, brought the issue to the UN Framework Convention on International Tax Cooperation, where one of two early protocols will address taxation of income derived from the provision of cross-border services in an increasingly digitalised and globalised economy.

Third, the US "withdrawal" from Pillar Two has uncertain consequences. The US has not implemented Pillar Two, while more than 50 countries are now implementing Pillar Two or in the process of legislation. Withdrawal has no direct impact on Pillar Two as a critical mass of jurisdictions is sufficient for the mechanism to work. This is currently the case as the European Union, Japan and the UK have adopted Pillar Two.

However, the memorandum's reference to tax rules "that are extraterritorial or disproportionately affect American companies" not only refer to DSTs but also concern the Pillar Two UTPR. The memorandum should be read in a way saying that the US does not tolerate that foreign countries would collect taxes on the under-taxed US profit. This has been a long-standing US Republican position. It is unclear whether this applies only to US company profits located in the US or extends also to US profits located in tax havens. Given the 21% corporate income tax rate in the US and generous tax credits (like the R&D credit), some US companies may have an effective tax rate below 15% and are therefore likely to be caught by the UTPR in other countries.

The memorandum tasks the Secretary of the Treasury to "develop and present to the President, through the Assistant to the President for Economic Policy, a list of options for protective measures or other actions that the United States should adopt or take in response to such non-compliance or tax rules". Beyond Section 301 US Trade Act trade sanctions, the Administration could use Section 891 of the US Tax Code, which gives the US government the authority to impose retaliatory taxes on businesses or individuals from countries deemed to be imposing unfair taxes to US companies. The tax rate on these companies could be doubled.

3. Starting a New Round — What Is Next?

President Trump began his term with a clear break from the Biden administration commitments, but the situation is more complicated than initial comments on the White House memorandum suggest.

The requested report on retaliatory measures from the US Treasury has not been published so far. What is clear is that the conversation between the US and its partners will move from cooperation to tensions. The lack of consensus at the 1st G20 Finance Ministers and Central Bank Governors Meeting in February 2025 is symptomatic of this new US approach. Further multilateral progress on international tax rules is off the table and the US will probably try to review the current agreements. Still, it is likely that the US keeps engaging with the Inclusive Framework on BEPS and the G20, as a common approach provides more tax certainty to businesses.

It is also clear that the US will trigger trade sanctions against countries implementing DSTs with the cancellation of the suspension of Section 301 sanctions decided by the Biden administration. Countries are left with the choice between unilateral action and facing trade retaliation on the one hand and giving up taxing rights on tech companies despite a lack of agreement on Pillar One. Canada is likely to suspend its DST, while Europe is unlikely to reach an agreement on a European DST, because Germany, Ireland or Nordic countries are averse

8 Santhie Goundar (2025). *Reeves Hints at U.S. Tariff Pressure Regarding U.K. DST*, https://www.taxnotes.com/tax-notes-today-international/budgets/reeves-hints-u.s-tariff-pressure-regarding-u.k-dst/2025/03/25/7rt1g.

to trade tensions and unanimity is required. This reflects broader difficulties in achieving a unified position within the European Union.

In parallel, a number of countries from the Global South have expressed growing interest in exploring alternative approaches. As a result, some are turning to the United Nations as an alternative platform for advancing international tax cooperation, which is uncertain to reach a tangible outcome.

During recent discussions at the United Nations, the United States delegation walked out, arguing that the proposed Tax Convention is inconsistent with US goals. "We reject the very nature of these discussions. The process that has been adopted will lead to a convention that would unacceptably hamper nations' ability to enact tax policies that serve the interests of their citizens, businesses, and workers," the US delegate said.

The European Union, represented by Poland, reaffirmed its commitment to participating in the process but emphasised the importance of consensus-based decision-making. In contrast, countries from the Global South advocated for a simple majority approach to avoid deadlock.

Despite these early divergences, negotiations at the United Nations are expected to continue. In the meantime, some countries may enact unilateral measures depending on their trade exposure with the US.

As regards the Global Minimum Tax, US withdrawal from the agreement has no direct impact, as the US did not implement the agreement, which has full impact if a critical mass of countries implement it. While countries like Japan, Canada and the UK could change their legislation, the European Union is unlikely to reach unanimity to change the directive implementing Pillar Two. European Commissioner for Taxation Wopke Hoekstra stressed the EU's commitment to Pillar Two, as the logic of Pillar Two in terms of tax fairness "simply has not changed; it is as convincing as it was".[9] Hence, it is very likely that Pillar Two will be fully entering into force in the European Union.

OECD Secretary General Mathias Cormann shared his optimism publicly by recently stating he is "quite confident that there is scope for a pragmatic and constructive resolution of the issues at hand" following a meeting with Scott Bessent, the US Secretary of the Treasury. It is unlikely that the US will fight countries for adopting Pillar Two, as the US also benefits from fighting low tax jurisdictions. Rather the Trump administration will fight for countries not to implement the UTPR against American companies. This requires a change of domestic legislation as Pillar Two is implemented through domestic legislation drawing on Model Rules. The US can also be expected to fight for the Model Rules to be changed or adapted. This is where US engagement with the International Framework and the G20 may be necessary to find a "permanent safe harbour" for companies based in jurisdictions with at least 20% statutory corporate tax rate.

Belt and Road Initiative jurisdictions should closely monitor the situation and how it evolves, noting that tax seems to have become second in the order of priorities given the gravity of trade measures announced by the USA on 2 April.

It is very likely that the Global Tax Deal is here to stay and will be applied by jurisdictions who have already implemented it, while discussions to accommodate US' demands ensue. Therefore, rather than consider Pillar Two as obsolete, governments should continue to anticipate potential impacts of Pillar Two on their tax competitiveness and pay increased attention to ongoing discussions at the OECD and the G20.

All in all, it is still too early to declare the Global Tax Deal dead, but observers were not so wrong when they invoked the image of the grim reaper. The Global Tax Deal reminds us that taxes and death are alike: there is just no easy way out.

9 Remarks made during the March 2025 EU Tax Symposium.

Time to Revisit the Attribution of Profits to Permanent Establishments*

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1. Introduction

The attribution of profits to Permanent Establishments (PEs) has been one of the core issues in international taxation in the past decades. Already in 1977, some changes were made to Article 7 and to its Commentary of the OECD Model Tax Convention (MTC). In 1984, the OECD addressed the issue of the attribution of profits to PEs by releasing a report specifically regarding banks.[1] Again a couple of years later, more precisely in 1993, the OECD issued a report on the attribution of profits to PEs, in which changes to the Commentary on Article 7 were proposed and incorporated into the 1994 OECD MTC. That was the last amendments to the Commentary on Article 7 before the updates in 2008 and 2010 OECD MTC. Subsequently, in 2018, additional guidance was released to deal with the Base Erosion and Profit Shifting (BEPS) developments and the attribution of profits to dependent agents.

Despite all these developments, the Authorized OECD Approach (AOA) remains a central element in international tax discussions. As proposed in this article, it is now a time for its reassessment due to several factors. First, the AOA introduced additional complexity in the attribution of profits to PEs. Second, the attribution of profits to PEs has led to an increasing number of disputes.[2] Lastly, new business

* This article reflects the personal opinion of the author.

1 OECD (1984). *Transfer Pricing and Multinational Enterprises — Three Taxation Issues*. Paris: OECD Publishing. See for a comment on this report, I.J.J. Burgers (1991). *Taxation and Supervision of Branches of International Banks: A Comparative Study of Banks and Other Enterprises.* Amsterdam: IBFD Publications, pp. 453-470.

2 Collier R. & Vella J. (2019). Five Core Problems in the Attribution of Profits to Permanent Establishments. 11 *World Tax Journal* 2, p. 160. For an overview of recent cases involving the attribution of profits to PEs, see Erasmus D. N. (2024). *Transfer Pricing and Profit Attribution to Permanent Establishments: Insights from Recent Cases,* https://www.taxriskmanagement.com/transfer-pricing-profit-attribution-permanent-establishments/. In addition, the recent decision of the Court of Justice of the European Union in the Apple case (Case C-465-20 P, 10 September 2024 European Commission v Ireland) also has led to criticism as the Court's application of the AOA. See in this regard, Verlinden I. & de Baets S. (2025). The ECJ Apple Judgment: A Sour Tarde Tatin. 32 *International Transfer Pricing Journal* 1.

models, most notably the digitalization of the economy, are emerging. This article starts by describing the AOA, then highlights some of the main problems related to the attribution of profits to PEs and the reason why the AOA has not succeeded in the author's view. Finally, this article draws conclusions on what could be the way forward to the revision of AOA.

2. The Attribution of Profits to PEs[3]

2.1 General Remarks

Article 7 of the OECD MTC is the key provision that provides the rules for the attribution of profits to PEs, through which an enterprise of one contracting state carries on business in the other contracting state. Article 7 has two functions.[4] The first function reflects one of the most fundamental principles in international tax law, according to which business profits are taxable only in the state of residence of the enterprise, unless that enterprise carries on a business in the other state through a PE. The PE concept then plays an important role in allocating tax rights. The second function is that once a PE is considered to be established in the source state (host state) in accordance with the rules provided in Article 5, such state acquires a right to tax the profits of the enterprise, but only those profits that are attributable to that PE. In that regard, although the existence of a PE is the required threshold to trigger source taxation of business income obtained by non-residents, there is a rejection of the force of attraction principle under the OECD MTC: the right to tax of the host state does not extend to profits that the enterprise may derive from the state otherwise than through the PE.[5]

For the purposes of determining the profits which are attributable to the PE and which are subject to the taxing jurisdiction of the host state, the principle is that the profits to be considered are those which the PE might be expected to make if it were a separate entity engaged in the same or similar conditions and dealing wholly independently with the enterprise of which it is a PE. When determining the profits attributable to a PE, one should consider the relationship between Articles 7 and 23 dealing with the elimination of double taxation.[6] Article 7 is addressed to the host state in determining the amount of profits that are attributable to the PE and that consequently can be taxed in that state. Article 23 is addressed to the residence state of the enterprise for determining the amount of income with respect to which relief from double taxation must be granted. Overall, it can be said that Article 7 plays a central role in facilitating cross-border trade and investment since: (i) it minimizes the risks of exposure of non-resident enterprises to taxation in other (host) jurisdictions; and (ii) it avoids inappropriate attribution of profits where a PE is found to exist.

The issue of the allocation of profits to PEs has always been a highly complex topic in international tax law due to the different views on the interpretation of Article 7. The roots of the problem lay in the somewhat "schizophrenic character" between the juridical reality that the PE is part of the worldwide enterprise and the economic reality

3 Sections 2.1 and 2.2 are the summarized and slightly updated versions of a previous article published by the author, see Bruno da Silva (2021). From the AOA to the New Article 7: The Attribution of Profits to PEs under the OECD MTC. *Revista ISG*, pp. 1-47.

4 Baker P. (2010). *Double Taxation Conventions*, London: Sweet & Maxwell, pp. 7-24.

5 Arnold B. J. (2003). Threshold Requirements for Taxing Business Profits under Tax Treaties. 57 *Bulletin of International Fiscal Documentation* 10, p. 478. Irene J.J. Burgers (2011). *OECD — Analysis Art. 7 OECD Model Convention: Allocation of Profits to a Permanent Establishment*. Amsterdam: IBFD Publications.

6 Russo R. (2005). Application of Arm's Length Principle to Intra-Company Dealings: Back to the Origins. 12 *International Transfer Pricing Journal* 1, p. 7.

that each function fulfilled by one part of an enterprise should be properly remunerated. In particular, it was considered that neglecting internal dealings between PE and general enterprise did not reflect a fair allocation of profits to the states where respective parts of the enterprise were located.[7] Therefore, notwithstanding the undisputable importance of the PE in the allocation of taxing rights to the source state, practice had revealed the existence of a considerable variation in the domestic laws of states regarding the principles to be applied in attributing profits to PEs. The lack of a common interpretation of Article 7 is proved to be a concern for global business, as it could lead to double taxation or less than single taxation.

2.2 The AOA

2.2.1 Background

Considering the existing conflicting views, the OECD wanted to establish a better and broader consensus regarding the interpretation and practical application of Article 7 based on the OECD MTC. That would enable the goal of minimizing the risk of double (or less than single) taxation to be achieved. The focus was on formulating the most preferable approach to attributing profits to a PE under Article 7 while considering the modern multinational operations and trade. The work performed by the OECD in the development of the AOA was not constrained by either the original intent or the historical practice and interpretation of Article 7 was culminated with the release of a report on 17 July 2008.[8] This 2008 Report has been divided into four parts: Part I (general considerations), Part II (special considerations for applying the AOA to banks), Part III (special considerations for applying the AOA to global trading), and Part IV (special considerations for applying the AOA to insurance companies). At the same time, the OECD Committee for Fiscal Affairs (CFA) recognized the existence of differences between some of the conclusions provided in the 2008 Report and the interpretation of Article 7 that was reflected in the Commentary on Article 7 prior to the adoption of this Report (1995-2005 Commentary).

Therefore, the OECD considered that, in order to provide maximum certainty to both taxpayers and tax administrations on how profits should be attributed to PEs, the adoption of the AOA should be made in two steps.[9] The first step was to provide guidance for the interpretation of existing treaties based on the wording of the former Article 7. A revised Commentary on Article 7 was then included in the 2008 updates to the OECD MTC. The 2008 Report was considered a source of guidance for the interpretation of Article 7 to the extent that its conclusions do not conflict with the 2008 Commentary on this provision.[10] The second step consisted in the drafting of a new Article 7 for adoption in future treaties (and amendments to existing treaties) which could allow the full implementation of the AOA and the conclusions stated in the 2008 Report. This was complemented by the updated commentary and also by the release of the "2010 report on the attribution of profits to permanent establishments."[11] Overall, the implementation of the AOA occurred on a two-staged approach: (i) the provisions of existing treaties that were drafted on the basis of the pre-2010 Article 7

7 See Irene J.J. Burgers, supra note 5.

8 See OECD Report on the Attribution of Profits to Permanent Establishments of 17 July 2008 (also referred throughout this article as "2008 Report"), para. 4.

9 See Mary Bennett, *Article 7 — New OECD rules for attributing profits to Permanent Establishments*, in Dennis Weber & Stef van Weeghel (eds.), pp. 25-26.

10 See paragraph 7 of the 2008 Commentary to Article 7 of the OECD MTC.

11 OECD (2010). 2010 Report on the Attribution of Profits to Permanent Establishments. Paris: OECD Publishing The document under discussion is also referred throughout this article as "2010 Report".

would follow the related 2008 Commentary on Article 7 as well as the guidance provided in the 2008 Report to the extent that its conclusions do not conflict with that Commentary; and (ii) the provisions of treaties that were drafted on the basis of the 2010 Article 7 would follow the related 2010 Commentary on Article 7 as well as the guidance provided in the 2010 Report.

2.2.2 The AOA process

The AOA requires a two-step process to determine the profits attributable to a PE.[12] The first step is to perform a functional and factual analysis in order to hypothesize the PE as a separate and independent enterprise, considering its functions, assets, assuming risks as well as its dealings with the enterprise of which it is a part and with related and unrelated enterprises. The second step requires determining the remuneration of any dealing by applying the Transfer Pricing Guidelines by analogy. The result of the two steps allows determining the profits of the PE from all its activities, which include these transactions with unrelated parties, transactions with related parties (by directly applying the Transfer Pricing Guidelines), and dealings ("transactions") with other parts of the enterprise.[13]

Performing a functional and factual analysis was considered the most appropriate way to hypothesize the PE as a distinct and separate enterprise. This was already used in situations involving associated enterprises for the purposes of applying Article 9, as it underpins the arm's length principle. The guidance on the functional analysis provided in the Transfer Pricing Guidelines is then applicable in the PE context in order to determine the "activities" of the hypothesized distinct and separate enterprise.[14] That requires determining which activities and responsibilities of the enterprise are associated with the PE and to what extent. Additionally, it requires determining in what capacity those functions are performed (i.e., if the services are performed for another part of the enterprise or as a function of the PE on its own).

However, it was also recognized that within the context of Article 7 there is a fundamental difference: a PE is essentially a tax fiction. In other words, from a legal perspective, a PE and its head office are the same entity.

There is no single part of the enterprise that legally owns assets, assumes risks, possesses capital or enters into contracts. Therefore, for the purposes of taking into account risks assumed and assets used, the legal analysis performed under the functional analysis of the Transfer Pricing Guidelines could not be directly and fully applicable. It was necessary for these purposes to supplement the functional analysis to enable the PE to be regarded as a distinct and separate enterprise. This was achieved by relying on the significant people functions analysis. The functional and factual analysis should identify the functions performed by personnel (people functions) and their significance in generating profits. Reference is made to the fact that people functions can range from support or ancillary functions to significant people functions relevant to the attribution of economic ownership of assets and/or the assumption of risks. Accordingly, the AOA attributes to the PE those risks for which the significant functions relevant to the assumption and/or management of risks are performed in the PE and also attributes to the PE the economic ownership of assets for which significant functions relevant to the

12 See, inter alia, Baker P. & Collier R. (2009). 2008 OECD Model: Changes to the Commentary on Article 7 and the Attribution of Profits to Permanent Establishments. 63 *Bulletin for International Taxation* 5/6, pp. 199-203. Bennett M (2008). The Attribution of Profits to Permanent Establishments: The 2008 Commentary on Art. 7 of the OECD Model Convention. 63 *European Taxation* 5, pp. 467-471.

13 The term "dealings" is used to refer to a change of functions, economic ownership of assets and/or risks within the same enterprise while "transactions" refer to dealings between different enterprises.

14 See paragraph 90 of the 2008 Report.

economic ownership are performed by people in the PE.[15] In addition, the AOA also sets forth different approaches to attribute free capital to the PE to support the functions it has performed, the risks assumed, and the assets attributed to it. Overall, the key factor in attributing profits to PEs is to look to the location where "significant people functions" are performed which are relevant to either the "economic" ownership of assets or the assumption of risks.[16]

The second step of the AOA determines the profit of the hypothesized separate enterprise so created. The dealings will then be compared with transactions of independent enterprises performing the same or similar functions, using the same or similar assets, and assuming the same or similar risks. The analysis takes into account the five comparability factors used in the Transfer Pricing Guidelines: functional analysis, characteristics of property or services, contractual terms (in case of a PE, reference is made to the "terms of the dealings"), economic circumstances, and business strategies. The AOA considers that all the factors, except for contractual terms, can be applied directly to evaluate dealings as they are essentially based on facts. The most appropriate method to reach an arm's length compensation should be chosen considering the functions performed, the assets owned, and the risks assumed by the PE.

2.3 The AOA Unsuccess

A fundamental problem in the AOA application lies in its conceptual idea, which is to treat a PE as far as possible as a (hypothetical) separate and independent enterprise. While conceptually the idea was understandable and rational, which was to treat separate legal entities, PEs, and head office as closely as possible in terms of profit attribution, the reality has shown far more difficult. The legal fiction of treating the PE as a separate and independent enterprise has created uncertainties and led to disputes, as highlighted elsewhere in this article.[17]

Another reason is that, under the AOA, the key element for the attribution of profits refers to significant people's functions. In other words, the attribution of profits to countries is determined based on the location where people perform significant functions. However, this gives rise to two problems. First, how to deal with this concept in the case of digitalized economy where there are often no people presenting at the source state. Second, the central role given to the significant people's functions is not followed by the necessary guidance explaining what active decision making is combined with simplicity for its administration.[18]

Finally, the staged application of the AOA, combined with its non-application by countries, led to an outcome where there are currently four different alternatives as regards the attribution of profits to PEs, adding increasing complexity and uncertainty in a topic which, by itself, is by no means simple. In fact, it is possible to have the application of: (a) the 2010 version of Article 7 that implements in its plenitude the AOA; (b) the 2008 version of Article 7 that adopts the AOA to the extent that it does not conflict with Article 7 in force; (c) the 2008 version of Article 7 but without the application or a mere limited application of Article 7; and (d) the application of Article 7 of the United Nations (UN) Model Convention.

This means that though the AOA aimed to achieve a harmonized approach for the attribution of profits to PEs, this goal has not

15 See paragraph 18 of the 2008 Report.

16 See Mary Bennett, supra note 9, pp. 23-24.

17 Collier R. & Vella J. (2019). Five Core Problems in the Attribution of Profits to Permanent Establishments. 11 *World Tax Journal* 2, p. 169; Dziurdź K. (2024). Attribution of Functions and Profits to a Dependent Agent PE: Different Arm's Length Principles under Articles 7(2) and 9? 6 *World Tax Journal* 2, pp. 145-149.

18 See Collier R. & Vella J., supra note 17, p. 171.

been successful. First of all, it is worthwhile remembering that the AOA itself provided for alternative options, notably as regards capital attribution, therefore jeopardizing the purpose of having a harmonized approach for the attribution of profits to PEs.[19] In addition, as mentioned before, the AOA was introduced in its plenitude under the 2010 version of Article 7 of the OECD MTC. However, this Article was subject to reservations by many OECD member countries and differing stances by non-OECD member countries.[20] Already in the early stages of its implementation, it appeared that the AOA had been received with skepticism.[21] Recently, the OECD acknowledged the non-consensual views on the AOA, stating that:[22]

"It is important to note that: (i) relatively few treaties currently include the new version of Article 7 which was included in the OECD Model in 2010; (ii) through reservations and positions included in the OECD Model, a number of OECD and non-OECD countries have expressly stated their intention not to include the new version of Article 7 in their treaties; and (iii) the inclusion of the new version of the Article in the UN Model (and, therefore, the implementation of the full AOA with respect to Article 7 of the UN Model) has been expressly rejected by the UN Committee of Experts on International Cooperation in Tax Matters."

In fact, currently 10 OECD member countries have formulated reservations to the application of the AOA and reserved their right to apply the pre-2010 version of Article 7.[23] In contrast, non-OECD member countries were even less eager to implement the AOA. As reflected in the UN MTC Commentary, back in 2009, the UN Committee of Experts on International Cooperation in Tax Matters had already taken the position of rejecting the adoption of the AOA, considering that the AOA was in direct conflict with Article 7(3) of the UN MTC, which generally disallows the deduction of payments between PE and head office.[24]

Overall, this demonstrates the rather limited success in the implementation of the AOA by countries.[25] Currently, there are no clear and reliable standards concerning rules on attribution of profits to PEs.[26] Ultimately, it is fair to conclude that the outcome of the AOA was not to provide for a unified approach as regards the attribution of profits to PEs, but rather there is more than one "appropriate approach" for attributing profits to PEs.[27]

19 See Collier R. & Vella J., supra note 17, p. 166.

20 Das R. R. (2019). Is the Arm's-Length-Principle-Based Authorised OECD Approach to the Attribution of Profits to a Permanent Establishment Losing its Authority? 73 *Bulletin of International Fiscal Documentation* 12, p. 661.

21 See Mary Bennett, *supra* note 9, p. 34 when referring that "[…] *there are a number of States that are hesitant to adopt the new approach* […]".

22 OECD (2016). Public Discussion Draft — BEPS Action 7: Additional Guidance on the Attribution of Profits to Permanent Establishments. Paris: OECD Publishing. The document under discussion is also referred throughout this article as "2016 Draft Report".

23 See Collier R. & Vella J., supra note 17, p. 167.

24 See para. 1 of the Commentary to Article 7 of the United Nations Model Double Taxation Convention Between Developed and Developing Countries 2021.

25 See Collier R. & Vella J., *supra* note 17, p. 167. Baker P. (2018). The League of the Nations' Draft Convention for the Allocation of Business Income between States — a new starting point for the attribution of profits to permanent establishments. *British Tax Review* 5, p. 514.

26 Andrus J. L. & Collier R. S. (2017). OECD Discussion Draft: Additional Guidance on Attribution of Profits to Permanent Establishments. *British Tax Review* 5, p. 515.

27 See Collier R. & Vella J., supra note 17, p. 167 and OECD (2018). *OECD Additional Guidance on the Attribution of Profits to Permanent Establishments, BEPS Action* 7. Paris: OECD Publishing, para. 46.

3. Conclusion: the Way Forward

Considering all the issues raised above, the question is now to discuss what could be the way forward. The starting point is that there appear to be growing views now that there is indeed a need to revise the attribution of profits to PEs.[28] This brief article does not purport to provide an exhaustive discussion of potential alternatives for attributing profits to PEs. I will leave this for a future contribution to expand on. In any case, I would like to highlight some ideas for reflection.

A recent proposal that has been submitted is to go back to the origins of the attribution of profits to PEs as reflected in the League of the Nations' Draft Convention.[29] Article 3 of the Draft Convention provides that the separate accounts maintained by the PE should be the starting point for the attribution of profits to PEs.[30] If the separate accounts do not reflect the appropriate amount of profits to be attributable to the PE, then adjustments could be required.[31] In cases where separate accounts are not provided or suitable adjustments cannot be made, Article 3 provided that tax authorities could calculate the amount based on the turnover or some other appropriate method. Finally, Article 3 stated that in case any of the previous methods could not be applied, then it was possible to make use, as a last resource, of formula apportionment to calculate the PE profits.[32] In any case, Article 3 also acknowledges that transfer pricing and profit attribution to PEs are not necessarily identical realities, as in the first case we are dealing with separate legal entities, while in the second one we are within the same entity.

At the same time, it is urgent to reflect on the issue of the attribution of profits to PEs in the context of the digitalized economy. This is certainly one of the current core issues that needs to be addressed. The lack of agreement coupled with the complexity of Amount A calls for alternative solutions. Apart from the idea of nexus and the need for a modified PE threshold, the fundamental issue is how to attribute profits to a "digital PE". Perhaps, in this case, relying on existing transfer pricing principles rather than entirely departing from existing rules may constitute a more viable alternative. There is some evidence that the existing arm's length principle may also be used in the context of digitalized businesses.[33] Therefore, exploring options and improving the existing legal framework may be a sound alternative for resolving the problems surrounding the attribution of profits to PEs.

28 See notably the interview of Manoel de los Santos, OECD Head of the Transfer Pricing Unit suggesting that there is the need for indeed revisiting the attribution of profits to PEs. See Heussner R., Lobb A. & Weigelt Y. (2024). *Deloitte OECD Interview Series — Part Two: Attribution of Profit to PEs and the Authorised OECD Approach*, https://www.internationaltaxreview.com/article/2cuif1o2nxo7h1938sf7k/sponsored/deloitte-oecd-interview-series-part-two-attribution-of-profit-to-pes-and-the-authorised-oecd-approach.

29 This proposal has been submitted by Philip Baker that suggests that the League of the Nations' Draft Convention for the Allocation of Business Income between States (also referred to as "the Draft Convention") should constitute a new starting point for the discussion on the methodology for attribution of profits to PEs. See Philip Baker, supra note 25, pp. 515-520.

30 See Baker P., supra note 25, p. 518.

31 See Baker P., supra note 25, p. 519.

32 See Baker P., supra note 25, p. 520.

33 Eden L. & Treidler O. (2019). *Commentary on the "OECD Secretariat Proposal for a 'Unified Approach' Under Pillar One, 9 October 2019-12 November 2019"*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3485881.

Prevention and Resolution Mechanisms for GloBE Disputes

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Abstract: This article discusses the topic of prevention and resolution mechanisms for Global Anti-Base Erosion (GloBE) disputes. As opposed to "traditional" bilateral disputes, GloBE disputes are highly likely to be multilateral in nature and therefore, more complex to address, which increases the need for mechanisms to enhance tax certainty at the cross-border level. The purpose of this contribution is to examine the mechanisms explored by the Organisation for Economic Co-operation and Development (OECD) and place this discussion within a Belt and Road Initiative (BRI) context.

Keywords: GloBE; Dispute prevention; Dispute resolution; Tax certainty; OECD; BRI; BRITACOM

1. Introduction

The Global Anti-Base Erosion (GloBE) Rules are a set of complex rules that aim to ensure the profits of multinational enterprises (MNEs) fulfilling certain requirements are subject to a minimum tax rate of 15%. They were designed as Model Rules (Model GloBE Rules)[1] through consensus reached at the level of the Organisation for Economic Co-operation and Development (OECD) Inclusive Framework (IF) and

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1 OECD (2021a). *Tax Challenges Arising from Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two)*, https://www.oecd.org/en/publications/tax-challenges-arising-from-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two_782bac33-en.html.

are complemented by a Commentary (GloBE Commentary)[2] and different sets of Agreed Administrative Guidance (together "the GloBE materials"). Through the issuance of these materials, the OECD IF sought to achieve an aligned application of the GloBE Rules across jurisdictions to the widest extent possible, by minimising divergences in their interpretation and application by different jurisdictions.

However, a uniform application of the GloBE Rules by all implementing jurisdictions cannot be ensured and disputes may arise. This is acknowledged in the Public Consultation Document (PCD) issued by the OECD under the title "Pillar Two — Tax Certainty for the GloBE Rules".[3] The PCD initiated a discussion about potential dispute prevention and resolution mechanisms for disputes resulting from the divergent application of the GloBE Rules by different jurisdictions. This article will examine the alternatives discussed in the PCD and assess their main characteristics. Moreover, it will seek to illustrate which of these alternatives would offer adequate solutions in the context of the Belt and Road Initiative (BRI).

The rest of the article is divided into 4 sections. Section 2 briefly discusses the particularity of GloBE disputes and underlines the importance of tax certainty. Section 3 presents the alternatives examined by the OECD in the PCD. Section 4 focuses on the options that the author considers as promising in the BRI context. Conclusions by the author are drawn in Section 5.

2. The Possibility for GloBE Disputes and the Increased Need for Tax Certainty

From their conception, the GloBE Rules are intended to have the status of a "common approach". In practice, this means that jurisdictions that decide to adopt the GloBE Rules are required to implement and administer them consistently with the GloBE materials and to accept the rule order and any safe harbours agreed.[4]

Despite their "common approach" status, the GloBE Rules will not be implemented through a multilateral convention of international law, but rather they will be enacted by national legislation in each implementing jurisdiction. As a corollary, there is a possibility that they are applied and/or interpreted in a varied manner by different jurisdictions.[5] In this respect, a distinction could be made between conflicts of interpretation and conflicts of transposition.[6] The former category includes cases where, notwithstanding the GloBE materials, tax administrations of two (or more) countries take inconsistent approaches regarding the interpretation of a rule of the GloBE framework. Conflicts belonging to the latter category would arise in cases in which an implementing jurisdiction, upon adopting the GloBE Rules, makes adaptations to better align them with its legal framework. Therefore, the existing potential for divergent application of the GloBE Rules could lead to disputes among jurisdictions ("GloBE disputes").

GloBE disputes will likely be much more

2 OECD (2022b). *Tax Challenges Arising from the Digitalisation of the Economy — Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two), First Edition*, https://doi.org/10.1787/1e0e9cd8-en.

3 OECD (2022a). *Public Consultation Document — Tax Certainty for the GloBE Rules*, https://web-archive.oecd.org/2022-12-20/648356-public-consultation-document-pillar-two-tax-certainty-for-the-globe-rules.pdf.

4 OECD (2021b). *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, https://www.oecd.org/content/dam/oecd/en/topics/policy-issues/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf, p. 3.

5 OECD, 2022a, para. 2.

6 R. Danon, D. Gutmann, G. Maisto, et al. (2023). The Global Anti-Base Erosion (GloBE) Rules and Tax Certainty: A Proposed Architecture to Prevent and Resolve GloBE Disputes. 6 *International Tax Studies* 2, pp. 4–6.

complicated than "traditional" double tax treaty (DTT) disputes, as they will be multilateral in nature. The GloBE architecture is such, that any discrepancies in the application of the rules among jurisdictions would highly likely have an impact on the foreseen rule order and ultimately on the Top-up Tax owed in different jurisdictions.[7] Even a genuine compliance mistake by a taxpayer could negatively affect multiple jurisdictions. This situation can be contrasted with DTT disputes, which are bilateral in nature and hence easier to prevent or resolve.

The likelihood of GloBE disputes, albeit to a certain extent limited through the reliance on the GloBE materials, increases the importance of achieving tax certainty. Tax certainty is key for countries that seek to attract investment and, in this context, would be ensured through mitigating or eliminating (to the extent possible) tax-related risk factors.[8] With this in mind, the discussion on tax certainty for the GloBE Rules is of fundamental importance.

3. GloBE Dispute Prevention and Resolution Mechanisms Discussed by the OECD

3.1 General Overview

The alternatives discussed in the PCD can be divided into two categories: dispute prevention and dispute resolution mechanisms. The aim of the former category of mechanisms is to ensure a common interpretation and/or application of the GloBE Rules by tax administrations and taxpayers at an early stage in the compliance or assessment process.[9] The prevention of disputes at an early stage can help tax administrations save resources compared with cases where they conduct uncoordinated audits that could potentially lead to disputes.

Despite being desirable from an efficiency perspective, the early prevention of GloBE disputes may not be always feasible. In certain cases, they might be unavoidable and jurisdictions should have in place a proper dispute resolution mechanism in order to overcome inconsistencies in the application of the rules.[10] Therefore, the PCD also discussed a dispute resolution mechanism for GloBE.

The mechanisms discussed in the PCD are not a panacea, as none of them can effectively address every potential source of GloBE disputes. Therefore, the author believes that they should not be viewed as mutually exclusive but as complementary to each other.

3.2 Mechanisms for the Prevention of GloBE Disputes

3.2.1 Reliance on the OECD GloBE materials

The first dispute prevention mechanism discussed in the PCD consists in the reliance on the GloBE materials. This approach would enable taxpayers and tax administrations to have a common understanding of how the GloBE Rules are to be interpreted and applied. It would help minimise interpretation issues and, thus, contribute to prevention of disputes at an early stage, for instance when taxpayers structure their business transactions and file their tax returns or when tax administrations conduct a tax assessment.

7 GloBE disputes may arise across the entirety of the GloBE Rules. Their examination is beyond the scope of this contribution. For examples of potential sources of GloBE disputes, see R. Danon, D. Gutmann, G. Maisto, et al. (2022). The OECD/G20 Global Minimum Tax and Dispute Resolution: A Workable Solution Based on Article 25(3) of the OECD Model, the Principle of Reciprocity and the GloBE Model Rules. 14 *World Tax Journal* 3, pp. 500–501; M. Herzfeld (2022). More on GLOBE Ordering: CFC Rules. *Tax Notes International* 106, pp. 604–605.

8 For the importance of tax certainty, see B. J. Arnold (2021). Some Thoughts on Tax Certainty. 2 *Belt and Road Initiative Tax Journal* 1; S. van Weeghel & B. Kuźniacki (2022). Raising Tax Certainty in Cross-Border Tax Disputes Through a Body of Experts. 3 *Belt and Road Initiative Tax Journal* 2.

9 Supra note 3, para. 4.

10 Supra note 3, para. 15.

Nevertheless, as the GloBE materials cannot guarantee an aligned interpretation and application of the GloBE Rules in all cases, divergent outcomes in different jurisdictions are expected to arise. Moreover, there may be cases where interpretation questions that arise have not yet been addressed or resolved.[11] To reinforce the common interpretation and application of GloBE Rules, the OECD has decided to develop a multilateral review process covering all chapters of the Model GloBE Rules.[12] Implementing jurisdictions will engage in a peer-review process and determine whether the rules implemented by other jurisdictions are "qualified". In this manner, the GloBE rule order will be given effect and, when a qualified rule is applicable, the rules of another jurisdiction will be "deactivated".[13] The envisaged peer-review process will be conducted on a multilateral basis and jurisdictions will not individually review every other jurisdiction.[14]

Insofar as a specific issue is not addressed by the GloBE materials, interested jurisdictions have the possibility of making a referral to the IF to request the issuance of Administrative Guidance. In this way, they can receive relevant clarifications contributing to resolving an issue and preventing issues of a similar nature from occurring in future cases.[15] Nonetheless, tax administrations and taxpayers cannot have recourse to IF concerning the application of the GloBE Rules in a specific case, as IF is a policy body that can only address questions of interpretation.[16]

The peer-review process and the referral to IF can prove valuable in ensuring further alignment of the interpretation and application of the GloBE Rules. However, their limitation is that they cannot provide tax certainty on the interpretation and/or application of the rules in a given case at the request of a taxpayer or a tax administration.

3.2.2 Common risk assessment through an ICAP-like mechanism

Another dispute prevention alternative examined by the OECD is a mechanism with the characteristics of the International Compliance Assurance Programme (ICAP)[17] that will enable common risk assessment and assurance across implementing jurisdictions. The OECD has defined ICAP as "a voluntary programme for a multilateral co-operative risk assessment and assurance process" and explains that ICAP has been designed to provide tax certainty in an "efficient, effective and co-ordinated" manner to MNE groups that cooperate with tax administrations actively, openly and transparently.[18]

In the context of ICAP-like programmes, tax administrations review at real time the taxpayer's internal systems and processes instead of auditing past events and transactions. By reviewing the taxpayer's tax control framework (TCF), a tax administration can be certain about the validity and correctness of the information

11 Supra note 3, para. 4.

12 Supra note 3, paras. 6–7.

13 OECD (2023a). *Minimum Tax Implementation Handbook (Pillar Two) (OECD/G20 Base Erosion and Profit Shifting Project)*, https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/minimum-tax-implementation-handbook-pillar-two.pdf, para. 83.

14 OECD, 2023a, para. 84.

15 Supra note 3, para. 9.

16 Supra note 3, para. 10.

17 OECD (2021). *International Compliance Assurance Programme*, https://www.oecd.org/en/publications/2021/02/international-compliance-assurance-programme_adf0be32.html.

18 OECD (2021). *International Compliance Assurance Programme — Handbook for Tax Administrations and MNE Groups*, https://www.oecd.org/en/publications/2021/02/international-compliance-assurance-programme_adf0be32.html, p. 6.

reported by that taxpayer, which creates justified trust towards the latter.[19] ICAP does not offer legally binding certainty, but *de facto* tax certainty (also referred to as "comfort"), which in this case means that the tax administration does not anticipate allocating resources for a further review of covered risks.

The OECD explains that MNE groups that carry on similar business operations across jurisdictions are likely to have a similar risk profile in these jurisdictions, which is relevant for GloBE purposes. In this respect, the strong point of an ICAP-like mechanism is that it would allow tax administrations to reach more consistent outcomes when interpreting and applying the rules, while avoiding unnecessary disputes. At the same time, taxpayers may obtain early certainty at multiple implementing jurisdictions.[20] In particular, through an ICAP-like mechanism, taxpayers could obtain comfort in relation to the methodology used for compiling the necessary information as well as regarding the accuracy of their computations.[21]

Such programmes encourage a relationship of cooperation, transparency and trust between taxpayers and tax administrations as well as between different tax administrations themselves. Furthermore, they allow achieving tax certainty across multiple jurisdictions in a more efficient and timely manner than other mechanisms.[22] However, the price to be paid for the benefits of efficiency and speed is that the taxpayer obtains *de facto*, rather than legally binding, tax certainty.[23]

An ICAP-like mechanism could be an efficient starting point for the prevention of GloBE disputes. As multiple tax administrations would conduct, assisted by the taxpayer, a common review of the latter's GloBE-related risks, they would form a common understanding of the relevant facts and circumstances. This would lead to an improved quality of disputes, as any ensuing disputes would concern points of law, rather than facts, and would be more easily resolved.[24] In any event, not all disputes could be avoided through an ICAP-like mechanism and therefore, resolution would still be necessary.

3.2.3 Tax certainty through an APA-like mechanism

The last dispute prevention mechanism referred to by the OECD is one having the characteristics of an Advance Pricing Arrangement (APA).[25] Depending on facts and circumstances, APAs can be agreed between two tax administrations or at a multilateral level. As opposed to ICAP, APAs can offer legally binding certainty to taxpayers. Nevertheless, they are invariably much more time consuming than ICAP and hence it could be questioned whether they are an ideal option for

19 For an overview about the concept of TCF and how justified trust can be achieved through it, refer to J. Owens, D. Dallhammer, J. Leigh-Pemberton, et al. (2023). The Role and Evolution of Tax Control Frameworks. *Tax Notes International* 111. See also T.A. Christodoulopoulos, J. Owens, J. Leigh-Pemberton, et al. (2025). From National Cooperative Compliance to Project-related Multilateral Cooperative Compliance. 17 *World Tax Journal* 2, sec. 3.1.4.

20 Supra note 3, para. 11.

21 Supra note 3, para. 12.

22 Forum on Tax Administration (2024). *International Compliance Assurance Programme (ICAP): Aggregated Results and Statistics*, https://www.oecd.org/content/dam/oecd/en/about/programmes/icap/icap-statistics-january-2024.pdf.

23 For an elaborate analysis of the benefits and (perceived) disadvantages of cross-border risk assessment and assurance programmes, see Christodoulopoulos et al., sec. T.A. Christodoulopoulos, J. Owens, J. Leigh-Pemberton, et al. (2025). From National Cooperative Compliance to Project-related Multilateral Cooperative Compliance. 17 *World Tax Journal* 2, sec. 4.4.1. and 4.4.2.

24 J. Owens, A. Piakarskaya, T.A. Christodoulopoulos, et al. (2024). The Use of Cooperative Compliance for Minimizing Cross-Border VAT/GST Disputes. 16 *World Tax Journal* 3, sec. 4.2.

25 Supra note 3, paras. 13–14.

the prevention of GloBE disputes.

Furthermore, the OECD states in the PCD that the legal basis that jurisdictions most commonly rely on to proceed in APAs is found in tax treaties (i.e., the equivalent of art. 25(3) OECD Model Convention[26] found in tax treaties between contracting states) and their objective is to align with a common standard, that is, the arm's length principle. For an APA-like mechanism to be effective in the context of GloBE, the OECD argues, a common standard would need to be defined. As no such common standard exists, it seems that the OECD does not currently consider such a mechanism appropriate for providing tax certainty in GloBE issues.[27] In the author's view, it is unclear why such a standard does not exist in the case of an APA-like mechanism, but actually does in the case of a dispute resolution mechanism, as the OECD advocates.[28] The author believes that the GloBE materials would be adequate to enable tax administrations to reach a certain conclusion in both alternatives.

3.3 Mechanisms for the Resolution of GloBE Disputes

A resolution mechanism for GloBE disputes can be built based on MAP (art. 25 OECD Model Convention), whose characteristics could be adapted to the particularities of the GloBE Rules. The aim would be to resolve issues arising for taxpayers from the divergent interpretation or application of the GloBE Rules by jurisdictions.[29] According to the OECD, that mechanism should comprise three basic characteristics:[30]

(1) The MNE should have the right to submit a request to the competent authority of a jurisdiction where an action of that jurisdiction could have as a consequence taxation not in line with the GloBE Rules;

(2) The competent authority in question and those of the other jurisdictions concerned should be empowered to resolve the case together, pursuant to a common standard; and

(3) Any agreement reached by the competent authorities should be implemented notwithstanding any domestic time limits.

A dispute resolution mechanism would only cover cases where a justified objection is raised by an MNE. The MNE considers that an action taken by one jurisdiction would lead to uncoordinated results for it, due to an interpretation or application of the GloBE Rules that is different from that of other jurisdictions. According to the OECD, its scope could be broad enough to cover all situations where a jurisdiction has interpreted or applied the GloBE Rules in a different manner, regardless of whether the MNE group is even required to apply them. Alternatively, its scope could be narrower, covering situations where an MNE group has to pay a Top-up Tax in several jurisdictions, while an approach even narrower would be to require the taxpayer to demonstrate that the outcome of a given difference in the interpretation or application of the GloBE Rules was double taxation.[31]

To resolve GloBE disputes, tax administrations would need to refer to a common standard allowing them to converge and reach an agreement on the interpretation and application of the rules in cases of inconsistent results. As a qualified Income Inclusion Rule (IIR), Undertaxed Profits Rule (UTPR) or Qualified Domestic Minimum Top-up

26 OECD (2017). *Model Tax Convention on Income and on Capital: Condensed Version 2017*, https://www.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2017_mtc_cond-2017-en.

27 Supra note 3, para. 14.

28 Supra note 3, para. 26.

29 Supra note 3, para. 16.

30 Supra note 3, paras. 16–19.

31 Supra note 3, paras. 21–24.

Tax (QDMTT) are anticipated to be consistent with the outcomes of the Model GloBE Rules and Commentary, the OECD argues that the role of the common standard could be played by the GloBE materials.[32] That common standard should be incorporated into the instrument chosen for dispute resolution.[33]

The OECD discusses four alternatives in the PCD for the implementation of a GloBE dispute resolution mechanism. First, through developing a multilateral convention (MLC) that would include tax certainty mechanisms as well as cover other relevant issues, such as exchange of information.[34] An MLC would include a provision giving the above-mentioned common standard priority over domestic law, thereby allowing competent authorities to resolve issues and implement the agreed solutions despite domestic time limits.[35] Although an MLC would be desirable from a policy and legal certainty perspective, it would require significant time to reach agreement at the IF level. Hence, it is unlikely that an MLC would be developed, at least in the short term.

The second alternative would consist in relying on competent authority agreements under the Convention on Mutual Administrative Assistance in Tax Matters (CMAA).[36] Art. 8 and 9 CMAA offer jurisdictions substantial leeway to consult together in order to determine procedures for the examination of GloBE disputes and exchange information. Nevertheless, taxpayers are not entitled under CMAA to seek dispute resolution through a competent authority procedure, nor does the CMAA provide a substantive legal basis allowing tax administrations to reach or implement agreements.[37]

Another alternative discussed is the dispute resolution provision of existing DTTs. Nevertheless, the equivalent provisions of both Art. 25(1) and (3) OECD MC have significant limitations. The former allows taxpayers to initiate a MAP case only when there is taxation not in accordance with a tax treaty, whereas the first sentence of paragraph 3 allows tax administrations to address questions regarding only the interpretation or application of the DTT at issue. However, GloBE Rules are unlikely to give rise to issues concerning the interpretation or application of DTTs and therefore, these two provisions could not support a GloBE dispute resolution mechanism. Moreover, the second sentence of Art. 25(3) OECD MC allows tax administrations to resolve issues extraneous to a tax treaty, but only when there is double taxation and further, does not grant taxpayers a right to file a resolution request.[38]

Last, the OECD proposes the creation of a dispute resolution mechanism under domestic law that would apply based on reciprocity.[39] The relevant provision would include all three elements discussed above, which the OECD considers fundamental for a GloBE dispute resolution mechanism. Nonetheless, certain jurisdictions might face legal or constitutional constraints in allowing a competent authority to agree on solutions that would depart from the domestic legislation implementing GloBE, in which case the mechanism may be available only to issues of

32 Supra note 3, para. 26.

33 Supra note 3, para. 28.

34 Supra note 3, para. 30.

35 Supra note 3, p. 31.

36 *Multilateral Convention on Mutual Administrative Assistance in Tax Matters: Amended by the 2010 Protocol, (2011)*, https://doi.org/10.1787/9789264115606-en.

37 Supra note 3, para. 35.

38 Supra note 3, paras. 36–38.

39 Supra note 3, p. 39.

interpretation.[40]

Some scholars have suggested a "lex specialis" model rule, according to which the Model GloBE Rules shall take precedence over domestic legislation implementing them in cases where a dispute arises because of their divergent transposition.[41] Although such a rule could perhaps be helpful for legal interpretation in cases where the Model GloBE Rules' wording has been *bona fide* adapted upon implementation in the domestic legal order, it is unclear to the author how such a rule would help in (the rare) cases where the divergent transposition would be due to domestic legal (i.e., constitutional) constraints. In this respect, it seems paradoxical that the legislator would adapt the wording of the Model GloBE Rules upon transposition to avoid a conflict with constitutional law and at the same time implement a lex specialis provision to allow the competent authority or national courts to apply the (model) provision that has a wording which it chose not to apply in the first place. Moreover, the author is not convinced by the argument that competent authorities can be empowered by domestic law to apply the Model GloBE Rules instead of another provision of domestic law in the same way that they are granted the authority by a DTT to diverge from domestic legislation in order to apply the treaty itself. The case where a DTT entered into pursuant to domestic procedures (usually through a parliamentary procedure) grants a competent authority the power to give priority to that same DTT over a provision of domestic law cannot be equated with the case where a domestic law provision requires a competent authority to apply a (non-binding) rule of a non-conventional nature (i.e., a model rule) over another provision of domestic law.

Developing a resolution mechanism for GloBE disputes appears to be a challenging task. The author believes that the most feasible option currently seems to be a dispute resolution mechanism based on domestic law. The scope of that mechanism should be broad enough and not have double taxation as an access requirement for taxpayers.[42] However, as mentioned above, even this proposal has its limitations as, in several cases, it might not cover disputes arising from conflicts of transposition.

4. Prevention and Resolution of GloBE Disputes in the Context of BRI

The discussion on prevention and resolution of GloBE disputes in the BRI context requires, first, to identify the extent to which BRI jurisdictions would be affected by the GloBE Rules. Jurisdictions that will be affected already in the short term are, notably, those that will implement the GloBE Rules (at least the QDMTT), that is, several EU member states and countries in the Asia-Pacific Region, as well as a handful of countries in Africa and South America. A second category of affected countries are those that have not implemented the GloBE Rules but are the headquarters jurisdictions of large MNEs that have subsidiaries in countries implementing the GloBE Rules. This category includes primarily China and to a lesser extent countries, such as the United Arab Emirates, Saudi Arabia, Indonesia and Kazakhstan. In the medium to long term, more BRI jurisdictions that participate in the IF are likely to be affected, insofar as they implement the GloBE Rules.

Considering the above factors, it should be noted that there is no"one-size-fits-all" solution when examining tax certainty mechanisms in the context of GloBE. In an ideal scenario, taxpayers and tax administrations would have at their disposal several dispute prevention and resolution mechanisms and could select the most appropriate one depending on facts and circumstances. However, the suitability of any of these mechanisms for different countries may be

40 Supra note 3, p. 42.

41 Supra note 6, pp. 8 and 10 et seq.

42 Supra note 3, para. 25; Supra note 6, sec. 3.1.1.

influenced by a variety of factors.[43] This is particularly true for BRI jurisdictions, spanning a multitude of countries across several areas of the world, which have varying types of economy and are at a different stage of development. Although some BRI jurisdictions implementing GloBE could in principle benefit from all mechanisms discussed in the PCD, not all tax administrations of BRI jurisdictions have the capacity required for some of them.

As a first step, tax administrations could explore opportunities to deepen their collaboration. The BRITACOM could play a significant role in providing training and technical assistance, engage in capacity building and promote knowledge sharing among tax administrations. Additionally, BRI could also seek to aid tax administrations enhance the cooperation among themselves and with the taxpayers to address potential compliance errors at an early stage.[44]

As the GloBE Rules are applicable at a multilateral (rather than a strictly bilateral) level, implementing BRI jurisdictions could also consider relying on mechanisms that have the potential to ensure maximum coordination among jurisdictions and provide certainty in a timely manner. In the author's view, an alternative that combines both of these elements would be an ICAP-like mechanism.[45] Certain BRI jurisdictions participate in ICAP and/or other programmes, such as the European Trust and Cooperation Approach (ETACA)[46] and already have (or will obtain) relevant experience in such mechanisms.

ICAP-like mechanisms are currently gaining momentum for several reasons: (1) they have a great potential to respond to the increased need of MNEs for tax certainty in the post-BEPS world, (2) they can complement and support existing cross-border dispute resolution mechanisms, (3) compliance frameworks designed for MNE groups are constantly improving, (4) collaboration between tax administrations at the international level is increasing, (5) (part of) information reporting for transfer pricing risk assessment has been standardised (i.e., Country-by-Country Reporting), and (6) the potential for tax administrations to efficiently capitalise, through multilateral engagement, on their access to an ever-growing volume of data.[47]

The above-mentioned elements highlight a trend towards multilateralism in the area of international tax law. The common approach introduced by the GloBE Rules constitutes a significant step towards tax multilateralism (regardless of their implementation through national legislation). The development of similar (yet complex) rules and standards in a globalised business environment increases the need for common solutions, such as ICAP-like mechanisms, in the area of dispute prevention and resolution.

Similar to ICAP, a large part of whose

43 T.A. Christodoulopoulos, J. Owens, J. Leigh-Pemberton, et al. (2025). From National Cooperative Compliance to Project-related Multilateral Cooperative Compliance. 17 *World Tax Journal* 2, sec 2.2.

44 See for example the proposed art. 9a on corrections to GloBE Information Returns in European Commission (2024). *Proposal for a Council Directive Amending Directive 2011/16/EU on Administrative Cooperation in the Field of Taxation*, COM(2024) 497 final, https://www.europarl.europa.eu/legislative-train/carriage/administrative-cooperation-in-the-field-of-taxation/report?sid=9001.

45 In certain cases, up to 9 competent authorities participated in ICAP risk assessments. Moreover ICAP risk assessments last on average 61 weeks, while APA and (post-2016) MAP cases reach 150 and about 100 respectively. See OECD, Forum on Tax Administration, 2024, pp. 21 and 26.

46 See European Commission (2021). *European Trust and Cooperation Approach — ETACA Pilot Project for MNEs*, https://taxation-customs.ec.europa.eu/eu-cooperative-compliance-programme/european-trust-and-cooperation-approach-etaca-pilot-project-mnes_en.

47 OECD, Forum on Tax Administration, 2021, pp. 6–7.

success resulted from the availability to tax administrations of the same information in the same format (i.e., CbC Reports), a mechanism with similar characteristics could be supported by the GloBE Information Return (GIR) provided for in art. 8(1) Model GloBE Rules.[48] Essentially, GIR would ensure a minimum of common information for tax administrations and make it easier for them to conduct a common risk assessment of taxpayers' methodology and calculations, in order to provide early certainty to affected MNEs.

The OECD suggests that an ICAP-like mechanism could be supplemented by coordinated inquiries, which would help create "a comprehensive common framework that would minimise disputes and ensure a cooperative and efficient use of tax administration resources."[49] Although this proposal is welcome, such a mechanism should not ensure a cooperative and efficient use of tax administrations' and taxpayers' resources. To this purpose, it could be considered publishing (anonymised) summaries of outcomes reached through such a mechanism. This would allow other taxpayers to be informed when assessing their own tax position,[50] thereby contributing to a further minimisation of GloBE disputes.

Despite its potential, an ICAP-like mechanism might eventually not result in the prevention of disputes arising from conflicts of transposition. For this reason, it should be complemented by dispute resolution. Another challenge that an ICAP-like mechanism could present, at least for some BRI jurisdictions, is that it would need some initial investment and might be resource intensive for certain tax administrations. Hence, BRI jurisdictions that are not affected by GloBE in the short term might not see this as an optimal solution in the short term, but only at a later stage. Different solutions might be more appropriate in such cases. One alternative that offers flexibility would be the use of mediation, for example by a Body of Experts as proposed by some scholars.[51] Nonetheless, it should be stressed that even such a mechanism, albeit simpler, would present difficulties due to the multilateral nature of GloBE disputes.

5. Conclusion

The pursued goal of aligned interpretation and application of the GloBE Rules through the issuance of the GloBE materials cannot be achieved in all cases, as jurisdictions will enact the GloBE Rules through domestic laws. Differences in the interpretation of the rules or a divergent transposition thereof at the domestic level will likely give rise to GloBE disputes between jurisdictions at the expense of affected taxpayers. It is, therefore, important to enhance collaboration among tax administrations and the BRITACOM can play an important role in providing to its members a platform for cooperation, knowledge sharing and capacity building in relation to GloBE.

To address potential GloBE disputes, the OECD is exploring in the PCD various dispute prevention and resolution mechanisms to provide certainty to taxpayers. The dispute prevention mechanisms examined by the OECD are the reliance on GloBE materials, an ICAP-like mechanism and an APA-like mechanism, whereas the dispute resolution mechanism is a MAP-like process that could be developed pursuant to different legal bases. None of them may address

48 OECD (2023b). *Tax Challenges Arising from the Digitalisation of the Economy — GloBE Information Return (Pillar Two)*, https://www.oecd.org/content/dam/oecd/en/publications/reports/2023/07/tax-challenges-arising-from-the-digitalisation-of-the-economy-globe-information-return-pillar-two_10977da1/91a49ec3-en.pdf.

49 Supra note 3, para. 12.

50 R. Russo (2020). Co-operative Compliance and ICAP in the Netherlands. In R. Hein & R. Russo (Eds.), *Co-operative Compliance and the OECD's International Compliance Assurance Programme*. Alphen aan den Rijn: Wolters Kluwer, p. 166; Owens, Piakarskaya, Christodoulopoulos, et al. 2024, sec. 2.3.

51 van Weeghel & Kuźniacki, 2022.

all types of potential disputes effectively and tax administrations should aim to have an arsenal of mechanisms to address GloBE disputes.

Given that the GloBE Rules have introduced a common standard for all jurisdictions implementing the global minimum tax, there is an increased need for common solutions to prevent and/or resolve potential disputes. An ICAP-like mechanism could provide coordinated solutions among jurisdictions in a timely manner. Its main advantage would be its potential to address multilateral disputes (such as GloBE disputes) without losing efficiency. However, like all other mechanisms examined by the OECD, it cannot provide a solution to all types of disputes. Moreover, it might be challenging for certain developing BRI countries with lower capacity. In this case, other mechanisms (e.g., mediation) might in principle offer solutions on a more realistic basis.

It remains to be seen what will be agreed at the level of the IF. In any event, the alternative(s) chosen should consider the specific concerns of developing and least developed countries that will (inevitably) be impacted, even if this occurs at a later point. The international tax community could perhaps take advantage of the discussions about a dispute prevention and resolution mechanism for GloBE to conceive a more institutionalised approach for cross-border tax disputes, which would ensure transparency, reduced costs and enhanced integrity of the process.

Promoting the Application of Generative AI in Taxation

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Abstract: Generative AI technology has made significant strides in language comprehension and reasoning, leading various industries, including the tax sector, to explore its integration of artificial intelligence (AI) into their management processes. Tax administrations, enterprise taxpayers and tax firms may leverage generative AI across multiple areas, including tax chatbots, tax assessment, tax analysis, and tax filing, among others. Nonetheless, the successful implementation of generative AI necessitates meticulous planning, robust data management, rigorous project trials, and potentially, organizational reforms to facilitate seamless integration.

Keywords: Generative AI; Taxation; Tax administration

1. Introduction

In recent years, the rapid advancement of artificial intelligence (AI) technologies, particularly ChatGPT, DeepSeek and other generative AI systems based on the Transformer Architecture, has demonstrated considerable potential for application across both general and specialized domains. Generative AI is becoming capable not only of comprehending and producing natural language but also of performing advanced logical reasoning, data analysis, and providing decision-making support.

According to Goldman Sachs, generative AI is projected to contribute approximately 7% to global GDP growth over the forthcoming decade.[1] However, the specific impact on the tax sector and how it will be realized are still under exploration. This technology is poised to drive improvements and transformative changes across various sectors, including tax administration, in-house tax management and professional tax services. Although the industrial application of generative AI

1 Goldman Sachs (2023). *Generative AI Is Projected to Contribute Approximately 7% to Global GDP Growth over the Forthcoming Decade*, https://www.goldmansachs.com/worldwide/greater-china/insights/Generative-AI-global-GDP.html.

remains in its early stage, certain jurisdictions are already witnessing substantial pioneering practices in the realm of taxation.

Currently, enterprise taxpayers are navigating complex fiscal and tax landscapes both domestically and internationally, which imposes heightened demands on the services of professional tax firms. Exploring and integrating of generative AI in the field of taxation are anticipated to enhance the efficiency and quality of tax services. Research conducted by Accenture in 2023 indicates that 39% of working hours within public sector organizations have significant potential for automation or augmentation through the use of generative AI.[2] According to IMF, AI will affect almost 40% of jobs around the world.[3] As tax administrations worldwide transit into the era of Tax Administration 3.0, as suggested by the OECD, the adoption of generative AI by tax authorities in numerous jurisdictions is becoming increasingly widespread.

2. Principles and Development of Generative AI

2.1 Technical Principles

Generative AI represents a specialized branch of AI technology that primarily relies on deep learning algorithms and neural networks. These systems are designed to extract essential rules and probability distributions from extensive datasets, thereby enabling the generation of new data through generative models. Key characteristics of generative AI include the utilization of substantial datasets, complex models, and significant computational power. The foundational principle involves employing neural networks to analyze and discern patterns and structures within the training data, facilitating the creation of new content — such as texts, images, videos, and codes — by both emulating human-like cognitive processes and extending the existing data patterns.

The predominant methodologies employed in generative AI comprise the Transformer Architecture, Generative Adversarial Networks (GANs), Variational Auto-Encoders (VAEs), and Diffusion Models. The Transformer Architecture is a deep learning framework based on self-attention mechanisms, initially being developed for large language models (LLMs). Its application has expanded beyond text to encompass image, video, speech, and multi-modal generation. GANs consist of a generator and a discriminator network trained in opposition, enabling the generation of highly realistic data, particularly in image synthesis and enhancement. VAEs are probabilistic generative models that encode input data into a latent space and decode it back, balancing reconstruction accuracy and latent space regularization, making them effective for tasks like image generation and anomaly detection. The Diffusion Model, a deep generative approach, generates new data samples by simulating natural diffusion processes, demonstrating strong performance in tasks such as image and audio generation, as well as other data generation applications.

2.2 Four Layers of Development

The contemporary evolution of generative AI is structured around four distinct layers: infrastructure, platform, model, and application.

➢ The infrastructure layer: This foundational layer includes hardware such as GPU chips, AI chips, supercomputers, as well as machine learning frameworks and cloud operating systems. This layer forms the backbone of generative AI development and deployment.

➢ The platform layer: This layer provides developers with essential tools and services through frameworks, algorithms, and architec-

2 Paul Daugherty, Bhaskar Ghosh, Karthik Narain, et al. (2023). *A New Era of Generative AI for Everyone*, https://www.accenture.com/content/dam/accenture/final/accenture-com/document/Accenture-A-New-Era-of-Generative-AI-for-Everyone.pdf.

3 Kristalina Georgieva (2024). *AI Will Transform the Global Economy, Let's Make Sure It Benefits Humanity*, https://www.imf.org/en/Blogs/Articles/2024/01/14/ai-will-transform-the-global-economy-lets-make-sure-it-benefits-humanity.

tures, facilitating the streamlined development and deployment of generative AI applications. This includes cloud platform services and open-source frameworks.

➢ The model layer: As the core of generative AI, this layer comprises general AI LLMs and industry-specific models derived from LLMs trained within particular sectors.

➢ The application layer: This final layer implements generative AI technology in end-user environments, delivering tailored solutions and enabling human-computer interaction through application programs.

The rapid proliferation of AI products based on LLMs is notably pronounced in jurisdictions such as the United States and China. Within the United States, prominent offerings include OpenAI's ChatGPT, the visual model DALL-E for image recognition and generation, Sora for video generation from text, Anthropic's Claude, Google's Gemini, Meta's Llama, Amazon's Titan, and the AI large language mixture of experts model (MoE) Grok developed by xAI, an AI startup founded by Elon Musk. In China, significant contributions include High-flyer's DeepSeek, Baidu's Wenxin LLM, Alibaba's Tongyi LLM, and Huawei's Pangu Model, which encompasses NLP, CV, multimodal, scientific computing, speech, Chain of Thought (CoT) and meteorological large models. Tencent's Hunyuan AI, Bytedance's Doubao LLM and Moonshot's Kimi are also notable. These LLMs are undergoing rapid iterative development.

3. Application of Generative AI in Tax Scenarios

3.1 Intelligent Q&As in Tax Knowledge

LLMs are increasingly capable of furnishing tax practitioners with intelligent responses to inquiries related to tax legislation, regulatory interpretation, tax treatment, and other pertinent issues. They also deliver timely updates on tax law changes and compliance requirements, covering new legislation globally. By leveraging AI-supported tax knowledge databases, tax professionals can access swift and expert answers to a wide range of tax-related inquiries encountered in their practices.

For instance, Google has integrated the Gemini model into its traditional search engine, launching the Search Generative Experience (SGE), which is a platform capable of summarizing results from tax information queries.[4] Additionally, H&R Block, a US-based tax service provider, has introduced the AI-powered Chatbot Tax Assist, designed to address various tax-related questions and offer guidance on specific tax regulations,[5] thereby optimizing the tax filing process and enhancing operational efficiency. Blue J, another US company, has developed Ask Blue J, an AI tax research platform that employs an extensive database of US federal income tax information, enabling users to undertake innovative tax analysis.[6] The Canada Revenue Agency (CRA) has also introduced Charlie, a 24/7 chatbot designed to answer taxpayers' frequently asked questions throughout the year.[7] The Inland Revenue Authority of Singapore (IRAS) utilizes IRAS Bot to address tax queries from taxpayers quickly and easily 24/7.[8]

3.2 Conducting Tax Assessment

For tax authorities, large models are employed to evaluate tax risk information, facilitating risk identification and screening of tax accounting and declaration data, with subsequent recommendations. According to Cum-

4 Google (2023). *Supercharging search with generative AI*, https://blog.google/products/search/generative-ai-search.

5 H&R Block (2023). *New H&R Block AI Tax Assist Provides DIY Tax Filers Instant, Unlimited Help with No Extra Fees or Upgrade Required for Live Tax pro Assistance*, https://resource-center.hrblock.com/newsroom/innovation/new-ai-tax-assist-diy.

6 BlueJ (2023). *Generative AI for Better Tax Answers,* https://www.bluej.com/how-it-works.

7 Canada Revenue Agency (2024). *CRA Chatbot,* https://www.canada.ca/en/revenue-agency/corporate/contact-information/cra-chatbot.html.

8 Inland Revenue Authority of Singapore (2025). *IRAS Bot*, https://www.iras.gov.sg/digital-services/others/iras-bot.

berland, Chief Process Officer of the Danish Tax Agency, AI auditing systems, once retrained on high-quality data, demonstrate exceptional performance, achieving higher hit rates than previously recorded.[9] A report by the IBM Center for the Business of Government, in collaboration with the American University Kogod School of Business Tax Policy Center, outlines the potential advantages of scaling AI use within tax agencies, including enhanced threat detection and more effective identification and mitigation of tax scams.[10] In the realm of tax collection, some administrations, including those in Finland, Ireland, Singapore, and Sweden, have already implemented predictive models to identify bad debts, thereby prioritizing enforcement actions. In Madagascar, the customs authority plans to use generative AI to improve risk management, combat fraud and increase revenue, using data accumulated over 10 years to train its system.[11]

For taxpayers, AI can assess the reasonableness and compliance of tax-related content based on contractual information or transaction records, subsequently providing recommendations. By employing large models, AI can determine applicable tax types, taxable items, and tax rates for specific transactions or matters, and compare these findings with existing tax accounting records or compliance outcomes to verify their accuracy. Notably, US legal AI startup Harvey and Bloomberg's legal division have advanced in analyzing contract terms, extracting key elements, and conducting compliance reviews by developing AI chatbots tailored for the legal sector.[12] Meanwhile, the Chinese enterprise resource planning (ERP) company Kingdee has introduced Kingdee Cloud - Cosmic GPT,[13] China's inaugural financial model, offering assessment and expert support functions in finance and taxation through vertical training in corporate finance, financial prompt engineering, and financial knowledge bases.

3.3 Assistance in Tax Analysis

Generative AI offers substantial support in drafting tax analysis reports, and examining variations in tax payments, effective tax rates, and tax incentives. It can autonomously acquire, calculate, and present data and metrics pertinent to tax analysis, generate charts and graphs intelligently, evaluate the effects of specific factors, and propose enhancements for tax management and business operations. The training and optimization of tax data models using generative AI algorithms facilitate the intelligent identification of tax risks and precise alignment with tax preferences, thereby offering innovative solutions for tax risk management. Furthermore, generative AI-driven predictive models are capable of reviewing large datasets, summarizing existing data, making deductive innovations, and providing users with insightful advice and decision support. By integrating with the business system's API capabilities, generative AI can unify analysis presentation, data penetration, business operations, and reasoning analysis, thus automating data analysis and report generation.

For instance, the State Taxation Administration of the People's Republic of China employs AI, including natural language processing, for comparison and de-duplication analysis, and is in the process of launching verification services for AI LLM applications in smart calling and office assistance. PwC has introduced a tax AI work-

9 Torsten Cumberland (2024). *A Look at the Risks and Opportunities for AI in Tax Administrations*, https://oecd.ai/en/wonk/risks-and-opportunities-ai-tax-administrations.

10 Caroline Bruckner, CollinCoil (2024). *AI and the Modern Tax Agency: Adopting and Deploying AI to Improve Tax Administration*, https://www.businessofgovernment.org/report/ai-and-modern-tax-agency.

11 Thomas Cantens & Herve Tourpe (2025). *How AI Can Help Both Tax Collectors and Taxpayers*, https://www.imf.org/en/Blogs/Articles/2025/02/25/how-ai-can-help-both-the-taxman-and-the-taxpayer.

12 Brian Baxter (2024). *Harvey Eyes 'All Sorts' of Lawyers in AI Legal Hiring Spree*, https://news.bloomberglaw.com/business-and-practice/ai-startup-harvey-seeking-all-sorts-of-lawyers-in-hiring-spree.

13 Kingdee. *Kingdee Cloud — Cosmic GPT: Reshape Enterprise Digital Capabilities*, https://www.kingdee.com/market/gpt.html.

bench designed to interpret tax policies, translate tax documents, analyze tax data, and furnish decision-making support for tax professionals.[14] In China, Join-Cheer's intelligent analysis assistant, powered by its Nvware GPT platform, can accurately discern analysts' intentions and convert query results into rich graphical presentations.[15]

3.4 Assistance in Tax Declaration

AI plays a pivotal role in facilitating tax declarations for enterprise income tax, value-added tax, and other tax categories. It accomplishes this by analyzing tax laws and filing requirements, assisting in the preparation of necessary documentation for tax declarations and related matters, and providing guidance on tax calculations and explanations. For instance, Intuit, a US-based company, has developed GenOS, a generative AI operating system incorporating LLMs for finance and tax, which includes a generative AI assistant to aid in preparing tax declaration materials within individual tax preparation software.[16] According to OECD's "Tax Administration 2023" report, tax administrations are increasingly leveraging AI and machine learning to make more intelligent use of data and to enhance the completeness of pre-filled tax returns.[17] The US Department of the Treasury announced that its enhanced fraud detection processes, including those for tax refund declarations using AI, recovered USD375 million in the fiscal year 2023.

4. Advancing the Application of Generative AI in Tax Area

4.1 Strategic Planning for Generative AI Application

The intelligent transformation of tax administration, tax services, and tax compliance procedures is emerging as an inevitable trend. Tax administrations are encouraged to adapt to the innovative and multi-faceted tasks facilitated by AI, while implementing robust AI strategies. Both professional tax firms and corporate tax departments must develop comprehensive strategies and plans for the intelligent evolution of tax services. It is highly advisable to establish a sound top-level generative AI strategy. In alignment with current technological advancements and specific needs of tax and tax-related domains such as tax returns and risk inspections, tax authorities, enterprises, and tax firms should devise medium-term plans for the deployment of generative AI, which will provide strategic direction and facilitate comprehensive deployment in subsequent application phases. When implementing generative AI technology, considerations must be given to the type of LLMs and access methods, evaluation and configuration of server resources, determination of deployment modes, and assurance of stable AI application system operations.

4.2 Enhancing Data Governance

Both tax administrations and taxpayers are required to establish rigorous tax data collection processes, enforce stringent data access controls, and implement effective encryption measures. Additionally, emphasis should be placed on operational risk prevention and control in model selection and developer engagement. Given the low fault tolerance of tax data, it is imperative for tax administrations and enterprises to actively construct a comprehensive data management system. By introducing a Data Management Capability Maturity Model (DCMM) as the framework, organizations can develop robust

14 PwC (2024). *AI Solutions for Tax, Helping to Open a New Chapter in the Intelligent Transformation of the Tax Service Industry*, https://www.pwccn.com/zh/industries/telecommunications-media-and-technology/publications/tax-ai-solutions-help-intelligent-transformation-may2024.html.

15 Join-Cheer (2024). *Nvware GPT Platform*, https://jiuqi.com.cn/nwAInl/37405.jhtml.

16 Intuit (2023). *Intuit Introduces Generative AI Operating System with Custom Trained Financial Large Language Models*, https://www.intuit.com/company/press-room/press-releases/2023/intuit-introduces-generative-ai-operating-system-with-custom-trained-financial-large-language-models.

17 OECD (2023). *Tax Administration 2023*, https://www.oecd.org/en/publications/tax-administration-2023_900b6382-en.html.

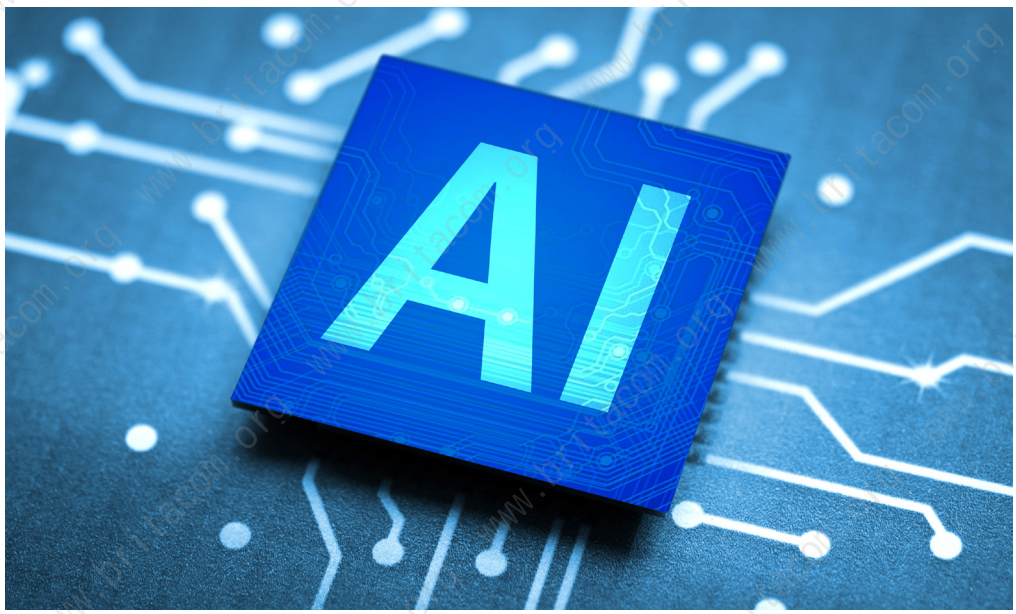
data strategy architectures and data cleaning and integration strategies. Strict monitoring and management of tax data processing, storage, and analysis must be enforced. Moreover, the phenomenon of LLM hallucination should be controlled through the application of various technologies.

4.3 Piloting AI Projects in Taxation

The development of generative AI in the field of taxation is rapidly progressing, and they are recommended that tax administrations, enterprises, and professional tax firms actively explore applicable scenarios and projects. Initiating AI demonstration projects and collaborating with LLM companies or specialized IT enterprises before committing additional resources may be a prudent initial step. Once these demonstration projects or functions prove feasible, demonstrating improvements in efficiency and accuracy, stakeholders can actively and incrementally advance the application of generative AI in taxation, thereby delivering significant value to tax professionals and their clients. While generative AI holds broad applicability, it is not omnipotent. Organizations must evaluate their operational scenarios, focusing on those that closely align with generative AI technology and offer high added value. Targeted deployment, cost-benefit analysis, and careful selection of suitable application scenarios for implementation are essential.

4.4 Management Reform and Staff Training

AI technology is emerging as a pivotal driver of new-quality productive forces. Since productivity influences production relations, management mechanisms must evolve in response to AI integration. For instance, because high-quality data is critical in effective AI application, data collection and use must extend beyond isolated departments to encompass the entire organization. As data-related issues in AI applications arise, defining responsibilities becomes challenging, necessitating reforms to existing data management mechanisms. To establish a new management framework, organizations should consider redesigning their structures, clearly delineating job responsibilities, and continuously optimizing work processes. Recognizing the limitations and challenges of generative AI technology, complete reliance on AI to replace human labor is inadvisable. Tax professionals should receive training to facilitate effective collaboration between humans and machines, so as to collectively advance organizational intelligence.



Micro Environmental Benefits of Water Resource Tax: Empirical Analysis from the Pilot Project in China (Part One)*

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Abstract: Water scarcity poses a significant challenge in China. While tax has emerged as a crucial policy mechanism for natural resource conservation, empirical evidence of its effectiveness at the firm level remains limited. This study investigates the impact of China's pioneering water resource tax reform on corporate environmental performance by analyzing panel data from 456 water-intensive listed companies between 2012 and 2022. Using a difference-in-differences approach, our findings reveal that the introduction of water resource tax significantly enhances firms' environmental performance. Through mediation analysis, we identify green innovation as a key channel through which water resource tax influences environmental performance, with this relationship persisting across various innovation metrics. Our

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heterogeneity analysis uncovers that the policy's effectiveness varies substantially across firm characteristics: maturer, smaller, non-state-owned, and financially healthier firms exhibit stronger environmental improvements. This research contributes novel micro-level evidence to the environmental regulation literature and offers valuable insights for policymakers in developing economies grappling with water resource management. Our findings suggest that market-based environmental policies can effectively drive corporate environmental responsibility while promoting technological advancement in water conservation.

Keywords: Water resource management; Micro environmental benefit; Industrial sustainable transition; Tax policy; Water resource tax

1. Introduction

Water scarcity stands at the forefront of environmental challenges in the modern era, posing significant threats to both environmental sustainability and economic growth on a global scale (World Bank Group, 2024). While multiple factors contribute to this growing crisis, industrial activities emerge as a particularly significant driver (Chowdhary et al., 2020). The scale of industrial water demand is substantial, comprising roughly 20% of global water withdrawals,[1] with this proportion rising to an even higher figure in economies undergoing rapid industrialization. The manufacturing sector, especially in water-intensive industries such as textiles, papermaking, chemicals, and metallurgy, places unprecedented pressure on already strained water resources.

The implementation of water resource tax and water pricing policies has emerged as a crucial policy in response to mounting water scarcity concerns. These market-based instruments represent a shift from traditional command-and-control approaches, to offering more flexible mechanisms to influence water consumption behavior (Wang et al., 2023). The fundamental principle underlying such resource tax is its ability to monetize natural resource value through fiscal mechanisms, designed to moderate the rapid expansion of resource-intensive industries. Empirical research has consistently demonstrated the effectiveness of resource tax in enhancing resource management efficiency and promoting the adoption of sustainable practices among businesses (Song et al., 2022). The economic impacts of water tax have been extensively studied through various methodological approaches. In a pioneering study, Berrittella et al. (2008) incorporated water as a production factor in a multi-region, multi-sector computable general equilibrium model (GTAP), revealing that water taxes not only reduce water use but also trigger significant shifts in production, consumption, and international trade patterns. Building on this foundation, recent studies have further explored the multifaceted effects of water pricing mechanisms. First, regarding direct water conservation effects, Xu (2020) indicated that the primary goal of setting up water resource tax is to reduce unnecessary water usage and Ouyang et al. (2024) found water resource utilization efficiency improved, and water use structure optimized through the water resources tax incentives. Second, concerning technological innovation, Xu et al. (2024) demonstrated that water resource tax creates strong incentives for firms to invest in water-saving technologies and cleaner production processes. Third, examining broader environmental implications, recent research has begun to uncover the "environmental dividend" of water resource tax. Li et al. (2024) found that water tax not only reduces water consumption but also leads to decreased chemical oxygen de-

1 Data sourced from the UNESCO World Water Assessment Programme. UNESCO (2018). *The United Nations World Water Development Report 2018: Nature-Based Solutions for Water*, https://unesdoc.unesco.org/ark:/48223/pf0000261424.

mand (COD) emissions and improved overall environmental performance. This suggests that water pricing policies may generate positive spillover effects across various environmental dimensions. However, the literature also reveals important heterogeneous effects across industries and regions. Yang et al. (2024) documented that the effectiveness of water resource tax varies significantly depending on various factors, such as regional water stress level, local institutional quality, and firm characteristics.

Despite these advances in understanding, crucial research gaps persist. While existing studies have predominantly focused on direct water conservation effects, limited attention has been paid to the potential "environmental dividend" of water resource tax, particularly in fostering green transition among water-intensive industries. This gap is especially notable, given the increasing emphasis on integrated environmental management and the potential for policy instruments to generate multiple environmental benefits.

The water resource tax reform represents a pioneering fiscal intervention specifically targeting water-intensive industries, which are primary contributors to industrial water consumption and environmental degradation. This method has a substantial and meaningful influence on the promotion of sustainable economic development (Qian, 2024). Unlike conventional environmental regulations that focus predominantly on pollution control, this tax reform adopts an upstream approach by directly addressing resource utilization patterns in water-intensive sectors, thereby fostering sustainable industrial practices. The strategic emphasis on these industries is particularly significant given their substantial water footprint and their pivotal role in China's industrial landscape. While existing literature has examined various aspects of environmental tax and resource management policies, the specific impact of water resource tax on corporate environmental performance (CEP) in water-intensive industries warrants deeper investigation. This research gap is particularly notable given that these industries are the primary targets of the policy intervention and their response patterns could significantly influence the policy's overall effectiveness. Understanding how water-intensive enterprises adapt their environmental practices in response to resource tax is crucial for evaluating policy efficacy and informing future regulatory frameworks.

This study addresses this research gap by examining whether and how water resource tax can generate broader environmental dividends and facilitate green production transformation in water-intensive industries. By focusing on this unexplored aspect, we contribute to both the theoretical understanding of environmental policy instruments and their practical implementation in achieving sustainable industrial development.

2. Policy Background

Prior to the water resource tax, China's water management relied on a fee system established under the 1988 Water Law. This decentralized approach faced significant limitations. The fragmented administrative structure led to inconsistent fee collection practices across regions and local authorities lacked standardized procedures. Inadequate monitoring mechanisms hampered enforcement efforts, particularly in rural areas with poor metering infrastructure (Qin et al., 2012). The fee structure failed to reflect water scarcity and environmental costs, with prices too low to encourage conservation. Additionally, institutional fragmentation created coordination difficulties and accountability gaps, complicating policy implementation across regions.

The water resource tax pilot policy is a significant component of China's resource tax reform and represents a major step following the reform of the resource tax. This policy was introduced against the backdrop of low collection standards and inefficient administration of the previous water fee system, alongside the pressing challenges of water scarcity and water pollution in China. The policy aims to enhance water resource management and promote the conservation and sustainable use of water resources

through fiscal measures. The water resource tax pilot project was implemented in 10 provincial regions, among which Hebei Province was selected as the first pilot region, starting from 2016. This selection was well-founded: Hebei faces severe water scarcity, with its per-capita water resources being only one-seventh of the national average,[2] and also suffers from significant groundwater over-extraction, particularly in the North China Plain. Additionally, Hebei has a well-established water resource management system and a substantial base for tax collection, with a high proportion of water-intensive industries in its industrial structure, making it a representative pilot region. Then this pilot project was extended to other nine diverse regions in 2017. The pilot provincial regions exhibit substantial heterogeneity in their socioeconomic and hydrological characteristics, encompassing variations in economic development, industrial composition, water resource endowment, and geographical conditions. They also represent distinct typologies of water management challenges, ranging from water-scarce regions with intensive industrial development to areas with abundant water resources but inefficient allocation mechanisms. This strategic selection of pilot regions with diverse water-economy nexus patterns provides a comprehensive framework for evaluating the water resource tax's effectiveness. The heterogeneous nature of these pilot provincial regions enhances the external validity of the policy assessment. Consequently, the insights derived from this pilot implementation offer valuable policy implications for regions facing similar water management challenges, regardless of their specific geographic or economic circumstances.

The pilot policy transformed water fee into water resource tax, implementing a volumetric tax system. Taxpayers include entities and individuals directly extracting surface water and groundwater, with the actual volume of water extracted being the tax base. The tax is uniformly administered by tax authorities. The implementation of water resource tax in China follows a differentiated rate structure that reflects regional heterogeneity in water resource endowments, utilization patterns, and economic development levels. While the central government establishes baseline tax rates, provincial governments retain autonomy in setting specific rates above these minimums, creating substantial regional variation in the tax burden. This decentralized approach has resulted in significant inter-provincial disparities, with surface water and groundwater tax rates varying by up to 16 times and 20 times, respectively, across regions. The spatial distribution of tax rates exhibits a clear correlation with regional water resource scarcity. In water-stressed North China, particularly in metropolitan areas, authorities have implemented more stringent tax policies. Beijing and Tianjin Municipalities, facing severe groundwater depletion, have set the highest groundwater tax rates at RMB4 per cubic meter. Adjacent provinces have adopted moderately high rates, with Shanxi Province and Inner Mongolia Autonomous Region levying RMB2 per cubic meter, and Hebei Province levying RMB1.5 per cubic meter. In contrast, provinces in East and Southwest China, benefiting from abundant water resources, maintain significantly lower groundwater tax rates, typically around RMB0.2 per cubic meter.

Additionally, the water resource tax policy takes into account the characteristics of various water users and includes corresponding incentive measures: lower tax rates for agricultural water use, exemptions for specific industries such as large-scale livestock farming, tax reductions for enterprises adopting advanced water-saving technologies, and stricter differential tax rates for groundwater in restricted and prohibited extraction areas. These measures ensure the feasibility of the policy while achieving the goals of water conservation and resource protection.

(To be continued)

2 Data sourced from the State Council of the People's Republic of China (https://www.gov.cn).

1 January 2025

Advancing the BRITACEG Global Multilingual Training Sessions

As of December 2024, the Belt and Road Initiative Tax Administration Capacity Enhancement Group (BRITACEG) experts have reviewed and enhanced all 65 courses within the curriculum system, which includes 4 themes, 8 topics, and 27 sub-topics. Furthermore, 6 Belt and Road Initiative Tax Academies (BRITAs) have been established, covering 6 languages: English, Chinese, Russian, Arabic, French, and Portuguese. Over 150 hybrid (online and on-site) training sessions have been conducted to date, attracting a cumulative total of 6,000 participants from more than 120 jurisdictions.

11 April 2025

Multilingual Video Column for the Fifth BRITACOF on the BRITACOM Website

Videos of the Fifth Belt and Road Initiative Tax Administration Cooperation Forum (BRITACOF) have been uploaded to the BRITACOM website (www.britacom.org). Each video features six language options — Chinese, English, French, Spanish, Arabic, and Russian — allowing viewers to select their preferred language for an optimal viewing experience. The videos cover the opening ceremony, closing ceremony, business and industry tax dialogue as well as main sessions of the Fifth BRITACOF.

21 April 2025

Update of the Tax Policy Library

To implement the *Hong Kong Action Plan (2025-2027)* and advance the construction of the tax policy library of BRI jurisdictions, we have invited 37 Member Tax Administrations to verify, supplement, and update the library. So far, the relevant content from 14 jurisdictions has been released on the website of the BRITACOM. This library aims to help all parties quickly understand the tax systems, administration frameworks, taxpayer service initiatives, and preferential policies of BRI jurisdictions, enhance the accuracy of tax policies, and promote trade liberalization and investment facilitation in BRI jurisdictions.

24-25 April 2025

BRITACOM Council Meeting Convenes in Beijing to Strengthen Global Tax Cooperation

The BRITACOM Council Meeting was convened at BRITA·Beijing on 24-25 April 2025. Over the two days, senior tax officials from more than 20 jurisdictions, along with representatives from international organizations and academia, engaged in in-depth discussions either on-site or online on strategies for enhancing international tax cooperation and promoting global economic governance. During the meeting, participants conducted thorough deliberations on the progress of BRITACOM and its future work plans. The delegates from the State Taxation Administration (STA) of China introduced the Tax Administration and Taxpayer Service Product Portfolios and delegates from 16 different jurisdictions shared the experience either on Tax Administration or Taxpayer Service. The meeting also addressed the development of the BRITACEG and their experiences and future plans.

25 April 2025

The Federation of German Industries (BDI) Joined the BRITACOM as a New Observer

During the BRITACOM Council Meeting in Beijing, the Federation of German Industries (BDI) was reviewed and approved to join the BRITACOM as an Observer. This milestone brings BRITACOM's Member Tax Administrations to 37, and Observers to 31, further strengthening its global network. Christian Kaeser, Chair of Tax Commission of the BDI delivered remarks, acknowledging the influence of BRITACOM in promoting global trade and tax certainty. This move underscores the BRITACOM's growing influence and its commitment to expanding its network of partners.

May 2025

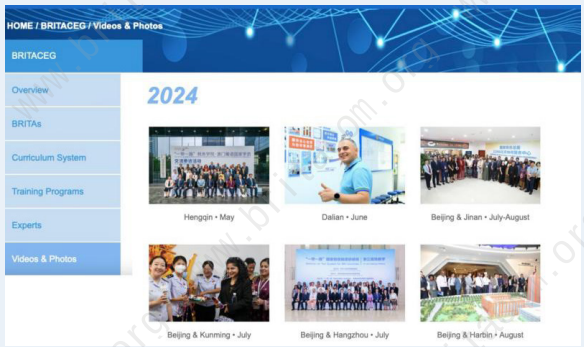
Implementation of the *Hong Kong Action Plan (2025-2027)*

The *Hong Kong Action Plan (2025-2027)* outlines the task schedule for the BRITACOM from 2025 to 2027, defines key areas of work, and establishes an implementation framework. Under the Action Plan, four task forces have been set up, focusing on raising tax certainty, promoting digital transformation of tax administration, improving tax environment, and reinforcing capacity building of tax administration. Regarding Chairs of the task forces, Macao SAR of China will take on this role for the task force on raising tax certainty; Kazakhstan will continue to be Chair for the task force on promoting digital transformation of tax administration; Cambodia will continue to chair the task force on improving tax environment; and China will continue to chair the task force on reinforcing capacity building.

May 2025

Enhancements to the BRITACOM Website

To enhance the role of the *Belt and Road Initiative Tax Journal*, a new column entitled "BRI Tax Journal Preview" has been launched on the homepage of the BRITACOM website, allowing users to access selected articles of the journal in advance prior to official publication. Sections of the website have also been continuously updated and optimized to display work progress of the BRITACOM and keep relevant parties updated. In addition, a new column titled "Videos and Photos" has been added under the section of BRITACEG, which features videos and photos of all training programs and on-site teaching activities in China from 2023 to 2024, showcasing wonderful moments and beautiful memories of the training programs.



11-15 May 2025

BRITA·Riyadh Held Workshops on VAT

From 11 to 15 May, BRITA·Riyadh held workshops on VAT in the financial sector and cross-border tax disputes. The primary objective of the workshops was to equip the participants with a clear understanding of VAT principles, compliance requirements as well as the regulatory and operational landscape of the banking sector in Saudi Arabia. Besides participants from Saudi Arabia, the workshops were also attended by participants from the Gulf Cooperation Council, including Qatar, Oman and the United Arab Emirates. Through the workshops, the participants' ability to navigate VAT regulations has been effectively improved.

13-23 May 2025

BRITA·Macao held a Seminar on Transfer Pricing

From 13 to 23 May, BRITA·Macao hosted a seminar on transfer pricing and 18 tax officials from nine Portuguese-speaking countries (namely Angola, Brazil, Cape Verde, Equatorial Guinea, Guinea-Bissau, Mozambique, Portugal, Sao Tome and Principe, and Timor-Leste) participated in it. During the seminar, the participants studied knowledge related to transfer pricing and corporate restructuring. Through theoretical learning, case analysis, and classroom discussions, they grasped the

latest developments and key points in the field of international taxation. In addition, from 15 to 16 May, the participants visited tax offices as well as the Huawei Base in Shenzhen, China. According to the participants, the seminar met practical needs and they benefitted a lot from it.

13-16 May 2025

Visit to Nepal to prepare for the Sixth BRITACOF

From 13 to 16 May 2025, the BRITACOM Secretariat visited Nepal to lay the groundwork for the upcoming Sixth BRITACOF. During the visit, the delegation held meetings with colleagues of Inland Revenue Department (IRD) of Nepal to discuss logistical arrangements, finalized key agenda items, and conducted on-site inspections of the proposed forum venue. The activities aimed to ensure the smooth organization of the Sixth BRITACOF, scheduled to take place in Nepal on 9-11 September 2025, while strengthening collaborative efforts between the two sides.

15 May 2025

The 9th Tax Administration Theme Day Event

On 15 May 2025, the 9th Tax Administration Theme Day Event was co-hosted by the IRD of Nepal, the STA of China and the BRITACOM Secretariat in a hybrid format. The event introduced tax policies, tax administration practices, and taxpayer services of both countries, aiming to establish a direct tax-enterprise communication channel for enterprises investing in Nepal and China.

18-24 May 2025

Seminar on "Tax Administration and Digitalization" Held by BRITA·Yangzhou

A seminar on "Tax Administration and Digitalization" was successfully held by BRITA·Yangzhou from 18 to 24 May 2025. The seminar was conducted in a hybrid format, with 27 attendees on-site and nearly 200 participants online. The 27 attendees are from 12 jurisdictions — Cambodia, Georgia, Hong Kong SAR of China, Hungary, Maldives, Mongolia, Morocco, Nepal, Saudi Arabia, Sierra Leone, Thailand and Uzbekistan. With most of the lectures in Chinese, BRITA·Yangzhou arranged English and French interpretation and BRITA·Astana provided Russian interpretation online. Besides lectures, visits to the Jiangsu Smart Taxation Experience Center and the taxpayer service hall of Guangling District, Yangzhou City were also organized. The seminar provided an in-depth understanding of the intersection between tax administration and digital technologies, offering practical insights and strategies for implementation.

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,

Editorial Department
Belt and Road Initiative Tax Journal

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