

# Abstract

The Belt and Road Initiative (BRI), as one of the most remarkable events of international economic cooperation nowadays, has noticeable implications for many areas of study. This article is to explore how BRI, an initiative proposed and championed by China, has influenced China's international tax system. To answer the question, the article sets two poles for depicting a country's position of international taxation, namely, the source-oriented tax system and residence-oriented tax system. Based on that, this article puts forward the proposition that there is a trend that China's international tax system is transforming from source-oriented to residence-oriented. To verify the proposition, this article uses a conceptual and factual approach to analyze the rule-based changes driven by BRI. And those changes are from two aspects, the domestic tax law and the bilateral tax treaty of China. In addition to them, the top design of BRI with particular reference to international tax policy will be discussed beforehand. In the end, the article is concluded by rendering the proposition as tenable.

## A. Introduction

The Belt and Road Initiative<sup>1</sup> is a regional and transnational cooperative economic framework launched by China, which aims to revive its ancient economic ties with Eurasian countries.<sup>2</sup> Although announced by President Xi Jinping only in 2013, the geographic coverage and economic data that BRI has achieved are eye-catching. Up to April 2019, China has signed BRI 'Cooperation Agreements' with 131 countries<sup>3</sup>, which has shown the parties' political commitment to further cooperating under the initiative. In the first 5 years (2013-2018) of BRI, the flow of foreign direct investment (FDI) from China to BRI countries had surpassed USD 90 billion, and the newly signed engineering project contracts valued more than USD 600 billion, with an annual increase rate of 11.9%.<sup>4</sup>

For China, BRI has been the strategic focus of the government since its launch. The Party and the central government ministries have been enacting guiding documents frequently to reform and regulate, but ultimately to facilitate the construction of BRI. Their efforts have covered considerable fields, including but not limited to infrastructure, technology, energy, environment, economy and so forth. Among those areas of rules, taxation has also been viewed as having a key role to play in advancing BRI.

The purpose of this article is to question the implications of BRI for the development of China's international tax system as a whole. And it presupposes that there exists a mode of transformation that could be used to capture the evolution of an international tax system. According to that, this article proposes the claim that under the influences of BRI, there is a trend that the international tax system of China ('ITSC'), is transforming from source-oriented to residence-oriented. To start the verification process of the claim, the Part B lays down some background information about BRI and the ITSC. Part C will elucidate the research claim and the verifying approach. Part D then turns to explore the top design

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1 The 'Belt' is for 'Silk Road Economic Belt', and 'Road' is for '21st-Century Maritime Silk Road'. In 2015, several ministries of China published the official English translation for BRI. Before that, the 'Belt and Road' was also mostly known as 'OBOR' for 'One Belt and One Road' or 'One Belt, One Road'. See for example, Zheng Yawen, *The Establishment of a Multilateral Investment Treaty for the 'One Belt, One Road' Initiative*, (2018) Special Issue Cambridge Law Review.

2 However, as shown in Chart 5, BRI reaches out further than Eurasia, which has embraced Africa, Oceania, North and South America into its map.

3 See 'List of Countries that Have Signed 'Belt and Road' Cooperation Document with China' <https://www.yidaiyilu.gov.cn/gbjg/gbgk/77073.htm>, accessed 30 April 2019.

4 See 'The Regular Press Conference of the Ministry of Commerce (MOFCOM) (18 April 2019)' <http://www.mofcom.gov.cn/xwfbh/20190418.shtml>, accessed 30 April 2019.

of BRI with a special reference to tax policies. Part E and Part F will identify and analyze the BRI-driven changes of the two components of the international tax system, respectively the domestic tax laws and the double tax agreements. For domestic part, the discussions will cover the foreign tax credit system and the controlled foreign corporation (CFC) regime. For tax treaty part, this article will inspect the changes from breadth and depth. For breadth, the analysis looks into the general picture of China's bilateral treaty network, while the depth part will discuss the content changes of sparing credit, the withholding tax liability, and the most-favored-nation clause. Based on all these discussions, this article is concluded by Part G revisiting the claim and rendering the result of the verification.

## B. The International Tax Law of China

### 1. BRI and International Taxation

Being a transnational framework, the key starting point of BRI is to `connect the markets of China and its partners in the BRI. Yet comparing the level of development of China and most of BRI countries, the export of investment from China outweighs China's import from BRI countries. As a result, such 'inter-connection' implicitly advocates more for the removal of barriers to the Chinese outbound investment at both the China side and BRI countries. The other way round, facilitating the inbound investment into China, however, only gains normative weight in the framework of BRI.

Based on the above, inspecting how China adjusts itself to the demand and reality of BRI may provide valuable insights to understanding China's strategy and foreseeing its future actions as well. This article, limits that inspection to the area of taxation, and more specifically, to the international aspects of corporate taxation.

### 2. China's International Tax System

The international tax system of China, or technically, China's foreign-related tax law has two components<sup>5</sup>, the domestic tax law and the double tax agreements (DTA) signed with other tax jurisdictions. And that composition generally reflects the basic norm of international taxation. The following only lays down some background information for the purpose of later and deeper discussions.

The current international tax model has been commonly accredited to the contributions made in the 1920s by the League of Nations.<sup>6</sup> To this day, if we compare the international tax law of China to the common international tax model, the former is still an 'infant' to the latter, which is going to celebrate its 100<sup>th</sup> anniversary. The ITSC was born in the 1980s, for the facts that either its first DTA was signed in 1983<sup>7</sup>, or that the first foreign-related enterprise income tax law was enacted in 1980 as well<sup>8</sup>. However, in modern times, China's international tax system is closer to maturity, after going through its 'adolescent' restlessness. That maturity can be partly explained by the so-called 'latecomer advantage', in that Chinese international tax system grows out of the modern international tax institutions.<sup>9</sup>

For one thing, the ITSC is consistent with the *residence-source* model of international tax model. China taxes the worldwide income of residents while providing foreign tax credit to eliminate double taxation. For non-residents, the Chinese tax liability is limited to the income derived within China. As a result, to be well-functioning, the residence-source international tax model is in turn dependent on the delineation of

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5 This relates to the nature of international tax law, see for example, Brian J. Arnold, Canada's International Tax System: Historical Review, Problems and Outlook for the Future, Canada in International Law at 150 and Beyond Paper No. 8, pp. 1-2.

6 de Wilde, Maarten Floris, 'Sharing the Pie'; Taxing Multinationals in a Global Market (January 15, 2015), available at SSRN: <https://ssrn.com/abstract=2564181>, p. 12.

7 SAT, 'List of Double Taxation Agreements Signed by China', see <http://www.chinatax.gov.cn/n810341/n810770/index.html>, accessed 1 May, 2019.

8 Income Tax Law of China Concerning Chinese-Foreign Equity Joint Ventures.

9 Jinyan Li, International Taxation in China: A Contextualized Analysis, IBFD, para. 1.3.2.2.

residence and source concepts. For the concept of residence, China uses the test of place of incorporation and place of effective management<sup>10</sup>, which is further supplemented by provisions of its DTAs (usually article 4). The identification of source is generally aligned with the categorization of incomes, of which the foundational division is between positive(business) incomes and passive(investment) incomes.

For another, China now has one of the largest tax treaty networks in the world. By the end of April 2019, China has concluded DTAs with 107<sup>11</sup> countries, even though the network has been ‘weaved’ only from 1983. The technical design of its DTAs follows either the OECD model or UN model so that all these tax treaties are basically the same in structure, and the divergence of content is limited. It is expected that China’s bilateral tax treaty network will further expand. As for the interplay of DTA with the domestic tax law of China, where there are conflicts the treaty provisions shall prevail.

## C. Research Claim and Verifying Approach

This article, with a focus on the implications of BRI for the international tax law of China, proposes that under the influences of BRI, there is an evolving trend that the ITSC is shifting from *source-oriented* to *residence-oriented*. This pair of terms, the source-oriented tax (SOT) system and residence-oriented tax (ROT) system, will be refined in the following.

To validate the above claim, a comprehensive approach to inspecting and evaluating the implications of BRI for China’s international tax system must be designed. For that purpose, this article uses a two-fold approach, which consists of a conceptual approach as core to identifying an international tax system as SOT or ROT, and a factual approach to systematically unfolding the concrete rule changes brought by BRI. The two sub-approaches work together to test the claim.

### 1. Conceptual Approach – Catching the Trend

The division of SOT and ROT is the conceptualization of and in line with a country’s relative stance on the so-called ‘inbound’ taxation and ‘outbound’ taxation.

In the case of China, the inbound taxation is the taxation of non-residents, on their incomes sourced from China, manifested as taxable *outflow* of income from China; while the outbound taxation is the taxation of Chinese residents, on their worldwide especially foreign-source incomes, manifested as taxable *inflow* of income to China. As inbound taxation arises from the country being the source of taxable income outflow, it can be entitled ‘source-based’ taxation (SBT). In the same vein, the outbound taxation can be named as ‘residence-based’ taxation (RBT). In this article, SBT and RBT refer to the two integral modules of the international tax system of a country.

SBT and RBT are inherently not overlapping or conflicting, for they are targeting different groups of taxpayers and incomes. And they do embody and reflect distinctive policy objectives and value orientations. The design of SBT rules aims to effectively tax the income of non-residents on one hand, on the other, they can play the role of attracting foreign investment. These two dimensions either echo the benefit principle that justifies the territorial taxation, or relate to the capital import neutrality (CIN) or the legal principle of non-discrimination. Correspondingly, besides effectively taxing the foreign income, the residence-based tax rules can be designed to facilitating outbound investment, by removing tax barriers or lowering tax burdens. Not free from controversies, the RBT is constructed upon ability-to-pay and capital export neutrality (CEN).

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10 Enterprise Income Tax Law of China, article 2.

11 SAT, ‘List of Double Taxation Agreements Signed by China’, see <http://www.chinatax.gov.cn/n810341/n810770/index.html>, accessed 1 May, 2019.