Tax risks and countermeasures of China’s OFDI under the Belt and Road Initiative

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Abstract. Since China put forward the "Belt and Road" Initiative in 2013, the investment exchanges between China and countries along the routes have become increasingly close, and gradually opened up a new pattern of global geo-economic trade. However, opportunities and challenges coexist. As the tax environment of countries along the "Belt and Road" is very different, Chinese enterprises face many tax risks in the process of OFDI. Based on the "Belt and Road" initiative, this paper studies the tax environment of the countries along the "Belt and Road". Through analyzing and discussing the tax risks of China’s outward direct investment in the countries along the "Belt and Road", it proposes relevant countermeasures to resolve the tax risks. It is hoped that through the joint efforts of the government and enterprises, the tax risks of OFDI can be effectively avoided and a good investment environment can be created, thus promote high-quality development along the Belt and Road. So this paper has both theoretical and practical significance.

Keywords: The Belt and Road Initiative OFDI Tax risks Countermeasures
**Introduction**

China is the implementation body of the Belt and Road Initiative for high-quality development. According to the *China's Outward Investment and Economic Cooperation Report (2022)*, the number of Chinese enterprises established in countries along the Belt and Road exceeds 11,000. Countries along the Belt and Road have become important destinations for Chinese enterprises to invest abroad. By the end of 2021, China has invested more than US $40 billion in overseas economic and trade cooperation zones of countries along the Belt and Road, paid more than US $4 billion in taxes and fees to host countries, created more than 300,000 local jobs, and made positive contributions to the economic and social development of countries along the Belt and Road.

Focusing on the field of tax, tax risk is an unavoidable topic for enterprises in the process of OFDI, and the tax risk of enterprises has always been a hot topic of research. From the perspective of enterprise tax risk, tax risk will not only frustrate enterprises' OFDI activities, but also directly cause investment failure or invalidation of investment objectives. From the perspective of macro international tax development trend, the international tax game will be further intensified, countries will strengthen the competition for tax sources, and in the process of responding to the "Belt and Road" initiative, they will be subjected to more stringent tax supervision, and the tax risk of OFDI will increase. In this context, it is very necessary to study the tax risks related to OFDI and put forward specific suggestions, which can help enterprises avoid tax risks as much as possible and make them more competitive in the international arena.

In recent years, under the background of the "Belt and Road" Initiative and the reshaping of global tax rules, China has actively participated in the formulation process of international tax rules and promoted the continuous implementation of rules. In August 2013, China took the initiative to join *The Multilateral Convention on Mutual Administrative Assistance in Tax Matters*. In 2015, China implemented the *Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information*. In September 2022, the *Multilateral Convention to Implement Tax*
Treaty Related Measures to Prevent Base Erosion and Profit Shifting officially entered into force in China, pushing the process of international tax cooperation to a new stage. In participating in the formulation of international tax rules, China has put forward positions and propositions on "revising the tax rules of the digital economy" and "taxing profits in the place where economic activities take place and value is created", which have received widespread attention and full recognition from the international community.

<table>
<thead>
<tr>
<th>Region</th>
<th>Tax treaty signatories</th>
<th>Tax treaty Non-signatories</th>
</tr>
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<tbody>
<tr>
<td>Asia</td>
<td>United Arab Emirates, Oman, Azerbaijan, Pakistan, Bahrain, Philippines, Georgia, Kazakhstan, South Korea, Kyrgyzstan, Cambodia, Qatar, Kuwait, Laos, Malaysia, Mongolia, Bangladesh, Nepal, Saudi Arabia, Sri Lanka, Tajikistan, Thailand, Turkey, Turkmenistan, Brunei, Uzbekistan, Singapore, Syria, Armenia, Iran, Indonesia, Vietnam</td>
<td>Afghanistan, Yemen, Iraq, Lebanon, Jordan, Maldives, Myanmar, Timor-Leste, Palestine</td>
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<tr>
<td>Africa</td>
<td>Algeria, Egypt, Ethiopia, Angola, Botswana, The Republic of the Congo, Gabon, Zimbabwe, Cameroon, Kenya, Rwanda, Morocco, South Africa, Nigeria, Senegal, Seychelles, Sudan, Tunisia, Uganda, Zambia</td>
<td>Benin, Burkina Faso, Burundi, Equatorial Guinea, Togo, Eritrea, Cape Verde, Gambia, Democratic Republic of the Congo, Djibouti, Guinea, Guinea-Bissau, Ghana, Comoros, Cote d'Ivoire, Lesotho, Liberia, Libya, Madagascar, Malawi, Mali, Mauritania, Mozambique, Namibia, South Sudan, Niger, Sierra Leone, SAO Tome and Principe, Somalia, Tanzania, Chad, Central Africa</td>
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**Methodology**

The research methods of this paper mainly include literature research and comparative analysis.

(1) Literature research method

Review the literature related to the tax risks of China's OFDI, comprehensively sort out the signing and revision process of Sino-foreign tax treaties, and then focus the research scope on the "Belt and Road", analyze the basic status quo of China's OFDI, and form my own opinions.

(2) Comparative analysis method

There are many countries involved in Chinese enterprises' OFDI under the "Belt and Road" initiative. By comparing and analyzing the tax regulations of different investment countries, this paper summarizes the forms of tax risks in the process of OFDI, and finally puts forward countermeasures to avoid tax risks.

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**Table continuation 1**

<table>
<thead>
<tr>
<th>Region</th>
<th>Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Europe</td>
<td>Albania, Estonia, Austria, Belarus, Bulgaria, North Macedonia, Bosnia and Herzegovina, Poland, Russia, Montenegro, Czech Republic, Croatia, Latvia, Lithuania, Luxembourg, Romania, Malta, Moldova, Portugal, Serbia, Cyprus, Slovakia, Slovenia, Ukraine, Greece, Hungary, Italy</td>
</tr>
<tr>
<td>America</td>
<td>Barbados, Cuba, Trinidad and Tobago, Jamaica, Argentina, Ecuador, Venezuela, Chile</td>
</tr>
<tr>
<td>Oceania</td>
<td>Papua New Guinea, New Zealand, Fiji, Kiribati, Cook Islands, Micronesia, Niue, Samoa, Solomon Islands, Tonga, Vanuatu</td>
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</tbody>
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Source: State Taxation Administration.
Result & Discussion

Tax risk analysis of Chinese enterprises' OFDI under the Belt and Road Initiative

(1) Tax differential risk
There are big differences in tax systems among countries along the "Belt and Road", and Chinese enterprises aren’t familiar with the tax system of the host country in the process of OFDI, which is an important reason for the risk of tax difference. Taking permanent institutions as an example, different countries have different definitions of permanent institutions, which leads to conflicts when countries exercise their respective tax rights, resulting in unnecessary tax costs for enterprises. At the same time, enterprises may encounter the host country's tax reform in the process of foreign investment. If enterprises do not respond to the host country's tax changes in a timely manner, additional economic losses may be caused.

(2) Risk of double taxation
There are many reasons for international double taxation. Although the signing of tax treaties can help enterprises avoid the risk of double taxation, some countries along the "Belt and Road" have a low degree of compliance with tax agreements, and often ignore the problems caused by overlapping tax jurisdictions for national interests. Some of the "Belt and Road" countries along the tax agreements signed earlier, generally framed, there are incomplete coverage, provisions are not updated in a timely manner and other problems. In the face of changes in the international tax environment, some provisions cannot solve the current tax disputes, which undoubtedly brings tax risks to enterprises when new situations arise. In addition, many countries along the Belt and Road have lower tax rates than China, resulting in enterprises in low-tax countries can’t enjoy the tax concessions of the host country.

(3) Transfer pricing risks
When Chinese enterprises invest in countries along the "Belt and Road", there will inevitably be connected transactions. For example, infrastructure enterprises with OFDI, especially communication enterprises, have mastered core patented technologies and must adopt internalized
transactions to prevent technology leakage. The Global Action Plan to Prevent Base Erosion and Profit Shifting (BEPS) has galvanized countries to focus on transfer pricing and other anti-tax avoidance issues. International tax cooperation has gradually changed from "avoiding double taxation" in the past to "avoiding double non-taxation". For example, overseas subsidiaries of enterprises are faced with tax risks caused by tax-related investigations caused by rigid handling of related transactions with parent companies and operations beyond the scope of business. Single-function subsidiaries will encounter the tax challenge of triggering a transfer pricing investigation due to the high pricing of imported goods.

(4) Risk of capital weakening

In the corporate income tax law of all countries in the world, the loan interest is generally allowed to be deducted before tax, but the dividend and bonus distributed by the company are not allowed to be deducted before tax, so the phenomenon of capital weakening is generated, that is, enterprises choose to use loans in order to reduce the tax burden, and less use equity investment. However, blind capital weakening will inevitably erode a country's tax base, and tax authorities of various countries have begun to pay attention to the problem of enterprises using capital weakening to avoid taxes. With the digitalization of tax collection and management and the globalization of tax information, some countries along the "Belt and Road" have begun to formulate measures such as the "principle of fixed debt and equity" and the "principle of reasonable transactions" to combat capital weakening. If Chinese enterprises in overseas investment and business activities, because they aren’t familiar with the tax laws and regulations of the host country and adopt the way of capital weakening to avoid taxes, they are very likely to be adjusted by the tax authorities of the host country, and then the enterprises will face greater tax-related risks.

(5) Tax dispute risk

The countries along the "Belt and Road" have different levels of economic development and significant differences in political demands, which makes it easy for Chinese enterprises to have disputes in tax collection and management in the
process of overseas investment. If these disputes are not handled in a timely and effective manner, it will bring greater risks to Chinese investors. China has signed a variety of tax treaties with countries along the Belt and Road, including the BEPS action plan and the Multilateral Convention on Mutual Administrative Assistance in Tax matters, but the contents of the agreements need to be improved, and the tax rules are not clear, which makes it difficult to guide enterprises to direct foreign investment. It can be said that although the number of tax treaties is large, it does not play its due role, especially in the part of tax disputes, most enterprises can’t make full use of international tax treaties. In addition, countries often have a serious tendency in dispute handling, and this exclusivity of Chinese enterprises leads to the host country to unilaterally increase the scrutiny in dispute handling, forcing Chinese enterprises to face the complicated dispute handling process, thus getting into a passive situation and bearing huge risks and losses of tax-related disputes.

Based on the analysis of tax risks, combining theory and practice, we propose relevant countermeasures to prevent tax risks in the process of China’s OFDI:

1. Optimize international tax treaties
With the further development of economy and trade of the "Belt and Road" countries, the realistic need of tax protection has put forward higher requirements for tax rules, and the existing tax agreements between China and countries along the "Belt and Road" can no longer cope with many changes in the tax environment under the background of high-quality development of the "Belt and Road". Therefore, China needs to optimize the tax agreements with countries along the route, timely modify the contents of the agreements that are not in line with the current tax system changes, increase tax credits, tax concessions and other provisions, clarify the scope and conditions for the application of preferential tax policies such as dividends, interest and royalties, and improve the implementation level of tax agreements. Reasonable distribution and balance of tax benefits of various countries, reduce or gradually eliminate double taxation, enhance tax transparency, simplify tax procedures, and
promote tax system reform. Jointly commit to a long-term cooperation mechanism for tax policy coordination among countries along the Belt and Road.

2. Establish a comprehensive tax-related consultation mechanism

Follow the principle of multi-interests and establish a diversified and differentiated tax cooperation mechanism and dispute resolution mechanism through negotiations. To find ways to solve tax disputes while seeking common ground while Reserving differences, and to improve the efficiency of tax dispute resolution according to the interests of all parties. In addition, it is also possible to establish a meeting mechanism for tax representatives of countries along the Belt and Road and a regional high-level dialogue mechanism to expand the tax cooperation network and deepen tax cooperation. The most important thing is to use the coordination power of international organizations in a timely manner and bring into play the positive role of international organizations in the settlement of international tax disputes.

3. Enhance tax service capacity

Government tax authorities need to establish a rapid response mechanism for cross-border tax appeals, while assisting with diplomatic means to provide the most convenient assistance to investors. Tax service authorities should accelerate the upgrading of data management of tax information, establish a mechanism for sharing tax-related information data in countries along the Belt and Road, broaden the channels for investors to obtain relevant tax information, and enhance investors' ability to resist tax-related risks. At the same time, in order to meet the professional needs of foreign-invested enterprises in taxation, the government tax authorities should pay attention to the training of international tax talents, organize and carry out personalized training mechanisms for foreign-related tax business, and send professional and technical personnel who are familiar with foreign-related taxation to the host country. Build a professional team for international tax administration by broadening the channels of communication with investment companies and enhancing tax service capabilities.
4. Enhance enterprise awareness of tax-related risk prevention

Investing is inherently risky. Some enterprises are accustomed to domestic government relations, economic environment and policy status quo, often use domestic management experience to deal with international tax matters, lack of tax risk assessment and planning. Enterprises tend to pay more attention to economic benefits in the process of OFDI, ignoring the importance of tax risk prevention. On the one hand, the tax risk prevention consciousness of enterprises is weak, and on the other hand, the tax management level of enterprises is insufficient. The prerequisite for enterprises to avoid tax risks is to carry out reasonable tax risk assessment. Before conducting OFDI, enterprises should work out effective investment plans and risk plans through investigation and research, so as to reduce the risk of anti-tax avoidance investigation and the possibility of tax disputes, enhance the certainty of tax, avoid double taxation and reduce the tax compliance cost of investors. Reduce the negative impact of tax risks on enterprises, and realize the optimization of investment tax benefits, so as to maximize the creation of investment profits. Finally, if cross-border enterprises want to be in a favorable development position in the severe international market environment and continuously improve their international competitiveness, they need to formulate reasonable tax planning schemes, establish a sound tax risk prevention mechanism, and improve their own tax risk prevention level.

5. Establish a good corporate image

The countries along the "Belt and Road" have their own religious beliefs, and enterprises should respect local culture and customs when making direct investment in these countries, and maintain friendly relations with local residents. Take the path of green development, protect the resources and environment in the production process, and at the same time carry out charitable sponsorship activities, assume the social responsibility of the enterprise, and lay the groundwork for the proper handling of tax disputes that may exist in the future. Enterprises can establish cooperative
relations with mainstream media of host countries, take the initiative to publicly disclose information, publicize the social influence and positive contribution of corporate projects, and show a good corporate image, which is conducive to the proper settlement of future tax disputes. Proactively abide by the declaration methods and filing deadlines of relevant taxes and fees, be familiar with different policy environments of target countries, and actively adapt to and integrate into them.

**Conclusion**

The economic level, political environment and customs of the countries along the "Belt and Road" are different, and China is faced with a complex investment environment in the process of OFDI. Chinese enterprises in the "Belt and Road" countries along the investment activities, inevitably face a lot of tax-related risks, in addition to common with the general foreign investment activities, tax risks have their own characteristics. The countries along the Belt and Road and the investment enterprises themselves should take active and effective measures to form synergy and jointly deal with these risks. By exploring the tax risks and countermeasures in the process of China's OFDI under the background of Belt and Road cooperation, this paper is helpful for Chinese enterprises to save tax costs and avoid tax risks in the process of OFDI, and provides certain reference and guidance for promoting the high-quality development of the Belt and Road cooperation. In short, foreign direct investment is not only related to the profit creation, survival and development of the investment enterprises themselves, but also related to the distribution and balance of interests among countries. In the face of the complex tax environment of countries along the Belt and Road, all international investment entities should take the interests as the core and the rule of law as the guarantee, and jointly think about and deal with the many tax-related risks faced by investors under the background of the Belt and Road Initiative. Cooperation and development have always been the core concept of promoting high-quality development of the Belt and Road. With the joint efforts of countries along the routes, the overseas investment environment for OFDI will continue to be optimized.
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References: