

Tax Treaties in China's Legal Order: Effectiveness and Recent Developments*

Wuyao Weng¹

1. Introduction

China's first tax treaty was concluded with Japan in 1983 and at the time of writing in August 2015, China had developed one of the most extensive treaty networks in the world, with 100 tax treaties, two tax arrangements (signed by Mainland China with Hong Kong and Macau)² and one tax agreement (signed by Mainland China with Taiwan)^{3,4}. By means of this network of tax treaties, China has been able to define the boundaries of the Chinese tax base and defend the tax base. However, in light of the functions of tax treaties defining the boundaries of the tax base at the international level, the tax jurisdiction of one country over incomes under its domestic tax laws has to be limited. As a result, for China's treaty partners, the definition of the boundaries of the tax base between them and China depends to a large extent on the effectiveness of tax treaties in China's legal order. In addition, due to the fast-developing economy, China's tax treaties are constantly changing, with the result that the boundaries of the

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¹ Wuyao Weng, Associate professor of fiscal and tax law in School of Civil, Commercial and Economic Laws at China University of Political Science and Law (CUPL).

² As part of the "one country, two tax systems" policy, Hong Kong and Macau are Special Administrative Regions of China with an independent legal and tax system.

³ With the economic relations between mainland China and Taiwan are thriving, the cross-strait agreement for avoiding double taxation and enhancing tax cooperation was concluded on 25 August 2015.

⁴ See website of State Administration of Taxation of China.

Chinese tax base are being modified. Following this introduction, this article will be divided into two sections. The first section will discuss Chinese experience with regard to the relationship between international law and domestic law in tax matters, and the second section will discuss the impact of the OECD and UN Models on tax treaties that China has concluded and revised over the past 32 years.

2. The relationship between international law and domestic law in tax matters: Chinese experience

With regard to the relationship between international law and domestic law, there are two important theories, i.e. dualism and monism. Generally speaking, dualism stresses the difference between domestic law and international law and treats them as separate legal orders regulating different matters. On the other hand, monism stresses the unity of domestic law and international law, treating the domestic and international legal systems as a unity⁵. But neither dualism nor monism is dominant in China and the majority of Chinese scholars adopt a compromise view, according to which, on the one hand, there are differences between domestic law and international law in the matters to be regulated, the sources of law, lawmakers and so on, and on the other hand, they are not in absolute opposition but in a relationship bringing together opposites. Both domestic law and international law manifest the state's will and their implementation requires mutual coordination⁶. The reason why the relationship between domestic and international law is interpreted in such a flexible way is related to the dialectical understanding of national sovereignty in China,

⁵ See C. DE PIETRO, *Tax Treaty Override*, Kluwer, 2014, pp. 17-19; C. YANG, *Jurisprudential Thinking about the Relationship between International Law and Domestic Law*, *Presentday Law Science (Journal in Chinese)*, 3/2014, pp. 103-104.

⁶ See T. YINGXIA, *Relationship between International Law and Domestic Law and Application of International Treaties in Chinese Domestic Laws*, *Social Science Front (Journal in Chinese)*, 1/2003, p. 177.

meaning that national sovereignty is sacred and inviolable and international law cannot override domestic law, thus avoiding interference in internal affairs by international law. However, national sovereignty is a relative concept and no country can invoke domestic law as the reason for non-fulfillment of its international obligations, for the purposes of maintaining the international order. China is no exception, also because China needs to integrate into the international community.

A compromise is apparent in China's position on two fundamental questions at issue, as discussed below (from the general overview to the specific analysis in tax matters), i.e. how international law realizes its legal effects in domestic law, and how the conflict is resolved between international law and domestic law in China.

2.1 Realization of legal effects of international treaties in the internal legal order

According to international practice, there are two basic ways in which international treaties achieve their legal effects in the internal legal order of a particular country: individual transformation, and automatic incorporation. In the case of individual transposition, an international treaty cannot be applied directly to the internal legal order but is applicable through legislation which transposes the international treaty into domestic law. In the case of automatic incorporation, once an international treaty is signed, the international treaty automatically becomes part of domestic law and is applicable directly in the internal legal order without the need for transposition into domestic law. The choice by a country of individual transposition or automatic incorporating is usually determined by the country's Constitution. However, in China, it is not possible to find any relevant provisions in the four Constitutions enacted since the founding of

new China in 1949 or in the 1990 Law on the Procedure for the Conclusion of Treaties. One possible reason appears to be the influence of the Soviet Union's Constitutions before 1977, which did not contain provisions concerning the legal effects of international treaties in the internal legal order. But the most important reason appears to be the historical factor. Following the 1840 Opium War, for over 100 years of semi-colonial history, old China signed many unequal treaties. As regards the international treaties signed before 1949, new China adopted a prudential approach dealing with each international treaty on its merits. As a result, Article 55 of the 1949 Common Programme of the Chinese People's Political Consultative Conference, the temporary constitution, provided that "*the central people's government of the People's Republic of China shall examine the treaties and agreements concluded between the Kuomintang and foreign governments, and shall recognize, abrogate, revise, or renegotiate them according to their respective contents*". Due to the fact that the Chinese Constitution does not specify how to realize the legal effects of international treaties, it is necessary to examine Chinese practice. In reality, the main way adopted by China to achieve the realization of the legal effects of international treaties in China is automatic incorporation⁷ whereas individual transposition is adopted in limited cases on the premise that the individual legislative act, formulated according to China's national conditions, is not in conflict with the international treaty. What can be inferred from this is that China is more influenced by the doctrine of monism in this respect, according to which the international treaty does not need to be transposed into domestic law and automatically, has effect on domestic law (incorporation).

First, the following are examples of the adoption of automatic incorporation from various sources of law other than the Constitution: 1) in terms of law,

⁷ C. HANFENG et al., *Relationship between International Treaties and Domestic Law and China's Practice*, *Tribune of Political Science and Law (Journal in Chinese)*, 2/2002, p. 117.

Article 142 of the 1986 General Provisions of the Civil Law provides that *"If any international treaty concluded or acceded to by the People's Republic of China contains provisions differing from those in the civil laws of the People's Republic of China, the provisions of the international treaty shall apply, unless the provisions are ones on which the People's Republic of China has announced reservations"*; ⁸ 2) in terms of administrative regulation, Article 12 of the 1990 Provisions on the Administration of Maritime International Container Transport provides that *"The containers used in maritime international container transport shall conform to the provisions and technical standards of the international organization for the standardization of containers, and also to the provisions of the pertinent international containers convention"*; 3) in terms of judicial interpretation, Article 112 of the 1991 Opinions of the Supreme Court of China about several issues on implementation of Administrative Procedure Law provides that *"When the documents need to be delivered to parties without domicile in China, the courts are able to use the ways provided in the international treaties concluded by China and countries where the addressees are"*. Moreover, China confirmed the automatic incorporating of international treaty in a diplomatic statement. On 27 April 1990, when examining the report on implementation in China of the United Nations Convention against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment, the Chinese representative responded to the question of the relationship between convention and Chinese domestic law, in the following terms: *"according to Chinese laws, the treaties concluded by China shall be approved by the legislative authorities or state council; they become effective for China and the provisions of treaties can be applied directly without the need for transposition into domestic law"*.

⁸ The words "provisions of the international treaty shall apply" imply the direct applicability of international treaty in civil matters in China.

Second, in the following two cases applying international treaties concluded by the Chinese government, China formulates new domestic laws or amends current domestic laws according to international treaties: 1) formulation of the 1992 Law on the Territorial Sea and the Contiguous Zone and the 1986 Regulations on Diplomatic Privileges and Immunities;⁹ 2) the 2001 amendment to the 1990 Trademark Law and the 2000 amendment to the 1984 Patent Law, in order to comply with the related contents of the Agreement on Trade-Related Aspects of Intellectual Property Rights.

2.2 Conflict between international law and domestic law: which has supremacy ?

As regards the second fundamental question of the relationship between international and domestic law, once again it is not possible to find any related provisions in the Chinese Constitution. However, it should be noted that in 1997 China signed the 1969 Vienna Convention which explicitly provides that a State cannot invoke its domestic law as a reason for the non-fulfillment of its international obligations. As a result, this self-evident principle of international law is accepted in China, and in practice China confirms the supremacy of international law in the domestic sphere, meaning that international law prevails over domestic law in cases in which the former contains provisions different from those in the latter. This rule is laid down in many Chinese domestic laws, such as the 1996 Criminal Procedural Law (Article 17), the 1997 Criminal Law (Article 9), the 1991 Civil Procedural Law (Article 238), the 1986 General Provisions of the Civil Law (Article 142), the 1985 Succession Law (Article 36), the 1989 Administrative Procedural Law (Article 72), the 1990 Copyright Law (Article 2), the 1992 Patent Law (Articles 18, 29 and 62), the 1993 Trademark Law

⁹ These domestic laws reflect the contents of the related international conventions.

(Article 9) and the 1987 Customs Law (Article 39).

As regards the supremacy of international law in the domestic sphere, the following points need to be considered: 1) the supremacy of international law can be considered as the result of the application of the principle *lex generalis non derogat legi speciali*, since with respect to domestic law, international law can be seen as special law; 2) according to Article 7 of the Law on the Procedure of the Conclusion of Treaties, the ratification of treaties and agreements containing stipulations inconsistent with Chinese laws shall be decided upon by the Standing Committee of the National People's Congress. On the basis of this provision, the supremacy of the international treaty can be considered as the result of the modification of domestic law by the Standing Committee of the National People's Congress through ratification of the treaties; 3) considering the nature of the Constitution, the status of international treaties is never above that of the Constitution in China; 4) according to the Law on the Procedure of the Conclusion of Treaties, there are three categories of treaties: treaties ratified by Standing Committee of the National People's Congress, treaties ratified by the State Council, and treaties ratified by Ministries. Due to the fact that in the hierarchy of domestic laws in China, the Constitution (enacted by the National People's Congress) is above ordinary legislation (enacted by the National People's Congress and its Standing Committee), ordinary legislation stands above regulations (enacted by the State Council) and regulations stand above departmental rules (enacted by Ministries), it is reasonable to conclude that unless otherwise provided in the specific law, treaties ratified by Ministries stand only above departmental rules, treaties ratified by the State Council stand only above departmental rules and regulation, and treaties ratified by the Standing Committee of the National People's Congress stand above departmental rules, regulations and ordinary

legislation.

2.3 Specific analysis of tax matters

As regards the relationship between international law and domestic law in tax matters, the first fundamental question is relatively simple: that is to say, practice in tax matters in China corresponds with general practice. As a result, China adopts automatic incorporation to realize the effects of international tax treaties in China's domestic tax system. However, the second fundamental question is relatively complicated: although in China the supremacy of tax treaties has so far been respected in practice in the case of conflict between a tax treaty and domestic tax law, its validity is questionable. In other words, is the supremacy of tax treaties absolute? In fact, it is reasonable to raise such a question in China, considering the following matters concerning tax treaties and tax law.

First, tax treaties deal with the problems of international double taxation and anti-evasion/avoidance in the field of income tax. However, in China, aside from the 2001 Law on the Administration of Tax Collection (Article 91) as a general tax procedural law,¹⁰ only the 2008 Law on Enterprise Income Tax recognizes the supremacy of tax treaties in the case of conflict, providing explicitly in Article 58 that "*Where provisions in the agreements on taxation concluded by the Government of the People's Republic of China with the governments of other countries are different from those of this Law, the provisions therein shall prevail*". Moreover, the 1980 Law on Individual Income Tax, amended six times so far, does not provide such a rule.

Second, according to China's current Constitution (the 1982 Constitution), the State Council exercises the function of conducting foreign affairs and

¹⁰ It provides that "*Where the provisions of treaties or agreements on taxation concluded between the People's Republic of China and other countries differ from those of this Law, the provisions of such treaties or agreements shall apply*".

concluding treaties and agreements with foreign states (Article 89, para.9) and the Standing Committee of the National People's Congress exercises the function of deciding on the ratification or abrogation of treaties and important agreements concluded with foreign states (Article 67, para.14)¹¹. However, in China, according to Article 7 of the Law on the Procedure of the Conclusion of Treaties, tax treaties are not classified explicitly as treaties and important agreements mentioned in Article 67, para.14 of Constitution¹². In practice, a tax treaty is signed by the State Administration of Taxation (previously by the Foreign Affairs Ministry) on behalf of the State Council, put on record in the State Council¹³ and published in the bulletin of the State Administration of Taxation. Therefore, unlike in the case of treaties and important agreements mentioned in Article 67, para.14 of Constitution, the Standing Committee of the National People's Congress does not determine the ratification of tax treaties, and tax treaties are not published in the bulletin of the Standing Committee of the National People's Congress. Moreover, it should be noted that in China's tax treaties, there is no rule providing that the treaty is subject to ratification. As a result, China's tax treaties can be seen as administrative (ministry) conventions and have the problem of a "democratic deficit". The absolute supremacy of tax treaties above domestic laws (unless provided in a specific law) ratified

¹¹ The same provisions can be also found in the Law on the Procedure of the Conclusion of Treaties (Article 3 and Article 7).

¹² Those classified explicitly as treaties and important agreements mentioned in Article 67, para.14 of Constitution include (1) treaties of friendship and cooperation, treaties of peace and similar treaties of a political nature; (2) treaties and agreements relating to territory and delimitation of boundary lines; (3) treaties and agreements relating to judicial assistance and extradition; (4) treaties and agreements which contain stipulations inconsistent with the laws of the People's Republic of China; (5) treaties and agreements which are subject to ratification as agreed by the contracting parties. But in view of the importance of taxation for national governance, tax treaties should be classified as treaties or important agreements mentioned in Article 67, para.14 of the Constitution. As regards the related analysis, see Liu Yongwei, *Important Convention and Unimportant Convention: Importance of Chinese—Foreign Tax Convention*, *Tribune of Political Science and Law (Journal in Chinese)*, 5/2008, pp. 176-177.

¹³ It seems that there is no specific procedure for ratification of tax treaties by the State Council.

by the National People's Congress is not a convincing argument in this connection.

Third, unlike traditional branches of law such as criminal law, civil law and administrative law, tax law needs to be amended and interpreted frequently in order to keep pace with the fast-changing economy. Generally, domestic tax law is amended first and then the tax treaty is correspondingly amended by way of protocols or renegotiation. For example, after the promulgation of the 2008 Law on Enterprise Income Tax, by which China reformed the enterprise income tax system, many earlier tax treaties (as described below) were completely renegotiated. However, in practice, it is not easy to formulate the protocols or completely renegotiate tax treaties, due to the fact that the related activities involve the interaction of two countries, and it takes time to complete the negotiating process. In this case, there is a need to implement the new domestic tax law, even if it contains rules incompatible with the non-amended tax treaties. This is logical and can be considered as the result of application of the principle of *lex posterior derogat priori*.

Fourth, due to fact that there is no general international rule according to which one country must take measures to eliminate international double taxation, the mandatory nature of international tax treaties is weak and in fact a contracting party can terminate the implementation of the tax treaty by informing the other contracting party without any reasons. For example, Article 29 of the China-Italy tax treaty provides that "*This Agreement shall continue in effect indefinitely, but either of the Contracting States may, on or before the thirtieth day of June in any calendar year beginning after the expiration of a period of five years from the date of its entry into force, give written notice of termination to the other Contracting State through the diplomatic channel.*"

Finally, some countries, such as Japan, accept the supremacy of tax treaties in the case of conflict, but in the meantime, provide also that domestic tax laws can prevail over tax treaties in cases in which the provisions of domestic tax laws are more favourable to taxpayers than the provisions of tax treaties¹⁴. In China, although there is no such provision in positive tax law, in practice this is not ruled out. For example, in general tax treaties impose a withholding tax on royalties at the rate of 10%, but Article 66 of the Rules on Implementation of the 1991 Law on Income Tax for Enterprises with Foreign Investment and Foreign enterprises (replaced by the 2008 Law on Enterprise Income Tax) provided certain specific royalties exemptible from income tax for the purpose of attracting foreign advanced technologies¹⁵ and in the case of these royalties paid to foreign enterprises, there was no withholding tax on them.

On the basis of the above analysis, it is reasonable to reach the conclusion that the supremacy of tax treaties should not be absolute and in specific cases domestic tax law should prevail over tax treaties¹⁶. Based on this conclusion, Article 91 of the 2001 Law on the Administration of Tax Collection and Article 58 of the 2008 Law on Enterprise Income Tax could be abrogated and these two laws could introduce more flexible provisions in

¹⁴ L. YONGWEI, *Relationship between China's Tax Treaties and Domestic Tax Law*, Law Review (Journal in Chinese), 4/2006, p. 60.

¹⁵ For example, royalties received in providing the following proprietary technology in respect of the development of important fields of science and technology: (a) production technology for major and advanced mechanical and electrical equipment; (b) nuclear power technology; (c) production technology for large-scale integrated circuits; (d) production technology for photoelectric integrated circuits, microwave semi-conductors and microwave integrated circuits, and manufacturing technology for microwave electron tubes; (e) manufacturing technology for ultra-high speed computers and microprocessors; (f) optical telecommunications technology; (g) technology for long-distance, ultra-high voltage direct current power transmission; and (h) technology for the liquefaction, gasification and comprehensive utilization of coal.

¹⁶ It should be noted that also the need for anti-treaty shopping through national anti-abuse rules contributes to reaching the conclusion above. See L. YIXIN, *Relationship between Convention for Avoiding Double Taxation and Domestic Tax Law*, International Taxation in China (Journal in Chinese), 11/1995, p. 21. As regards a detailed analysis of relationship between domestic anti-abuse rules and tax treaty provisions, see C. DE PIETRO, *Tax Treaty Override*, Kluwer, 2014, pp. 105-162.

the case of conflict between tax treaties and domestic tax law.

3. Impact of OECD and UN Models on China's tax treaties

The OECD Model Tax Convention on Income and on Capital was first published in 1963 (30 July)¹⁷ and the UN Model was first published in 1980 (1 January)¹⁸. As a result, when China decided to introduce the income tax system and conclude a tax treaty with foreign countries in the early 1980s after the launch of the reform of the economic system and the opening up of the economy to international trade, adopting the OECD or UN Models appeared to be the only viable option, in view of the fact that China was eager to integrate into the international community mainly consisting of western developed countries, and intended to be seen as following the international (tax) regime.

It is well known that the OECD Model is preferred by capital-exporting countries, because it emphasizes residence-based taxation, and the UN Model is preferred by capital-importing countries, because it emphasizes source-based taxation¹⁹. In fact, under pressure from various interests, generally the choice between the two models is not simply one or the other, but compound, meaning that in a tax treaty some articles are based on the OECD Model and some on the UN Model. Certainly, China is no exception. Moreover, in a changing world, in particular considering China's fast-growing economy, the choice between the two models is variable. The following analysis examines the impact of the OECD and UN Models on China's tax treaties and trends in China's tax treaty policy.

¹⁷ The most recent version of the OECD Model is the condensed version 2014.

¹⁸ The most recent version of the UN Model is that updated in 2011.

¹⁹ W. CHENGYAO, *Making Greater Efforts to Revise International Models of Convention for Avoiding Double Taxation*, *International Taxation in China* (Journal in Chinese), 8/2008, p. 34. As regards an analysis of the main differences between OECD Model and UN Model, see M. LENNARD, *The UN Model Tax Convention as Compared with the OECD Model Tax Convention – Current Points of Difference and Recent Developments*, *Asia-Pacific Tax Bulletin*, January/February, 2009, pp. 4-11.

3.1 Brief overview of developments of China's tax treaties in a fast growing economy over the past three decades

Since China began its transition to a market economy in 1979, the country has grown at an average rate of 9.8%,²⁰ although the growth rate has been diminishing since 2010. Although the growth rate in 2014 was a relatively anaemic 7.4%,²¹ as the International Monetary Fund said, this year China overtook the United States as the world's largest economy (according to purchasing-power parities). Undoubtedly, China's tax treaties have developed in this fast-growing economy. In fact, in the past 32 years since China's first tax treaty, the developments of China's tax treaties can be divided into three stages.

The first stage was from the early 1980s to the early 1990s. It is well known that in the early 1980s China introduced an income tax system as part of the economic reform programme and implemented the policy of opening up the economy due to the specific need for foreign capital and technology of developed countries. As a result, it was necessary to remove double taxation as a tax obstacle to the cross-border movement of capital and technology, and this was the main reason for China to conclude tax treaties. At this stage, obviously, the main characteristic of capital (and technology) flow was inward investment from developed countries, and China's tax treaties were concluded only with developed countries. China concluded a tax treaty with Japan in 1983, with France and UK in 1984, with Germany 1985, with Italy in 1986 and so on. In fact, the China-Japan tax treaty was the model for the tax treaties with other developed countries or OECD Member countries and country-specific variations were minimal. China was in the position of a net capital-importing country in negotiating tax treaties with OECD Member countries. Thus, China on the one hand

²⁰ See website of National Bureau of Statistics of China.

²¹ See website of National Bureau of Statistics of China.

generally insisted on more source-based taxation and on the other hand required tax relief, given that China introduced many favorable conditions in the domestic tax system in order to attract investment into the country. As a result, the tax treaties concluded by China as a developing country were mainly based on the UN model.

The second stage was from the mid- to late-1990s to the beginning of the twenty-first century. After almost twenty years with a high rate of economic growth, China had accumulated vast amounts of capital and in 1999 China initiated an effort to promote Chinese investment abroad. This effort is known as the Go Out Policy (also referred to as the Going Global Strategy). In the pursuit of this policy, China introduced many schemes to assist domestic companies in developing a global strategy to exploit opportunities in the expanding local and international market. Thus, the Go Out Policy required China to conclude more tax treaties in order to facilitate outward investment by Chinese companies. At this point, China's outward foreign direct investment rose sharply, in particular in other developing countries. As of 2009, China's investment stock in Asia, Latin America and Africa was respectively 185.5 billion USD, 30.6 billion USD and 9.3 billion USD, accounting for respectively 75.5%, 12.5% and 3.8% of China's total (outward) investment stock. In fact, as of 2009, China's investment stock in developed countries was 18.17 billion USD, accounting for only 7.4% of total (outward) investment stock²². As a result, the basic characteristics of capital (and technology) flow at this stage were as follows: 1) as regards capital and technology, inward investment (in China) mainly came from developed countries; 2) as regards capital, China's outward investments were mainly directed at developing countries. Moreover, the tax treaties concluded by China at this stage were mainly those with developing

²² See 2009 Statistical Bulletin of China's Outward Foreign Direct Investment.

countries. It should be noted that China still emphasized the rights of capital-importing countries in negotiating tax treaties with these developing countries, and these tax treaties were still mainly based on the UN model. As a developing country and friend of other developing countries, China might be more sympathetic to the concerns of capital-importing countries and thus more willing to concede to more source-based taxation than a typical OECD Member country. However, these tax treaties serve slightly different purposes from those concluded with OECD Member countries, as China is more likely to be an exporter of foreign direct investment to the treaty partner countries. In this connection, China could have taken the stance that is normally taken by OECD Member countries²³. In fact, at this stage, China started to gradually emphasize the rights of capital-exporting countries, thus adopting the OECD model in some articles.

The third stage concerns the past seven years. In 2008, China's new enterprise income tax law (enacted on 16 March 2007) entered into force. The new enterprise income tax law consolidates two separate enterprise income tax regimes for foreign invested enterprises and domestic enterprises and levels the playing field between them. It represents a fundamental change in China's tax policy towards foreign investment. Moreover, since the 2008 financial crisis, China has increasingly expanded the scale of its outward investment. In 2013, China's outward investments were close to 108 billion USD,²⁴ preceded only by the United States. Together with new developments in international tax treaty theory and practice relating to anti-abuse and arbitration and new developments in e-commerce, financial innovation (hybrid financial instruments) and in forms of economic organization (investment funds), these factors gave rise to the

²³ See L. JINYAN, *The Great Fiscal Wall of China: Tax Treaties and Their Role in Defining and Defending China's Tax Base*, Bulletin for International Taxation, September, 2012, p. 454.

²⁴ See 2013 Statistical Bulletin of China's Outward Foreign Direct Investment.

need for China to revise the early tax treaties, in particular those concluded with developed countries.

For a better understanding of the basic characteristics of the flow of capital (and technology) at this stage, it is necessary to examine the relevant statistics. First, although outward investment has increased constantly, China's outward investment stock is still relatively low, compared to developed countries. For example, as of 2013, China's outward investment stock reached 660 billion USD and ranked at 11 globally²⁵. Second, the vast majority of China's outward investments are still in developing countries and the growth rate of China's investments in these countries is higher than in developed countries. For example, in 2013, China's investment in Latin America and Africa increased respectively by 132.7% and 33.9%. As of 2013, China was the largest trade partner in Africa for the fifth straight year and China's investment stock in Africa rose to 25 billion USD²⁶. However, in 2013, China's investment in Europe declined by 15.4% (5.95 billion USD),²⁷ though it doubled in 2014²⁸. Third, although China continues to be an exporter of foreign direct investment with respect to developing countries, China's imbalanced flow of capital with respect to developed countries is changing. For example, in 2014, Germany investment in China was 2.07 billion USD (as per the actual input of foreign capital),²⁹ and China's investment in Germany was 1.6 billion USD³⁰. In 2014, Italy's investment in China was 0.37 billion USD (as per the actual input of foreign capital),³¹ and China's investment in Italy was 3.5 billion USD, preceded in Europe only by

²⁵ See 2013 Statistical Bulletin of China's Outward Foreign Direct Investment.

²⁶ L. HONG, *2014: Turning Year of China's Overseas Investment*, Economic Information Daily (newspaper in Chinese), August 15, 2014.

²⁷ See 2013 Statistical Bulletin of China's Outward Foreign Direct Investment.

²⁸ See Baker & McKenzie / Rhodium Group, Chinese investment into Europe hits record high in 2014.

²⁹ See Ministry of Commerce of China, Statistics of FDI in China in January-December 2014.

³⁰ See Baker & McKenzie / Rhodium Group, Chinese investment into Europe hits record high in 2014.

³¹ See Ministry of Foreign Affairs of China, Relationship between China and Italy (updated in July 2015).

China's investment in the UK (5.1 billion USD)³². In fact, these European countries have been the main destination countries of China's outward investment. Finally, it should be noted that with respect to technology, China is no longer a country only importing advanced technologies from other countries but has now started to export its own advanced technology, for example, the high-speed railway technology as part of China's export-oriented economy.

At this stage, on the basis of the analysis above, clearly China not only needs to conclude more tax treaties, including the latest one, the China-Chile tax treaty concluded on 25 May 2015, (so that all OECD Member countries now have tax treaties with China), but also to revise the early tax treaties concluded with developed countries, of which the 1985 China-Belgium tax treaty was the first one to be revised, in 2009. In fact, considering that the tax treaties have been revised by means of the promulgation of a new edition of the tax treaty, it is better to say "renegotiate the early tax treaties completely". In renegotiating the early tax treaties with developed countries, as illustrated in detail below, China no longer adopts the perspective of a net capital-importing country, and the revised tax treaties have been strongly influenced by the OECD model, although China still adopts the UN model in certain articles. However, China's positions may still vary from one country to another (with regard to developed or developing countries). It should be noted that China has started to take part in discussions on revising the OECD model and its commentaries (mostly on anti-avoidance) and China actively participates in the Base Erosion and Profit Shifting Action Plan (BEPS).

³² See Baker & McKenzie / Rhodium Group, Chinese investment into Europe hits record high in 2014.

3.2 Illustration of impact of the OECD and UN Models on China's tax treaties in recent years

As indicated above, in recent years China and its treaty partners have revised many early tax treaties. The revised tax treaties, concluded with European developed countries or OECD countries, include the 1985 China-Belgium treaty (revised in 2009), the 1986 China-Finland treaty (revised in 2010), the 1984 China-UK treaty (revised in 2011), the 1986 China-Denmark treaty (revised in 2012), the 1987 China-Netherlands treaty (revised in 2013), the 1990 China-Switzerland treaty (revised in 2013), the 1984 China-France treaty (revised in 2013) and the 1985 China-Germany treaty (revised in 2014). In addition, China's tax treaties concluded with the countries of Latin America and Africa in the past six years include the 2009 China-Ethiopia treaty, the 2010 China-Zambia treaty, the 2010 China-Syria treaty, the 2012 China-Uganda treaty, the 2012 China-Botswana treaty, the 2013 China-Ecuador treaty and the 2015 China-Chile treaty. In connection with the developments in China's tax treaties in recent years, the impact of the OECD and UN Models on China's tax treaties in recent years may be evaluated by taking the China-France treaty and China-Uganda treaty as examples.

3.2.1 Substantive articles on the allocation of taxing rights

The differences between the OECD and UN Models lie in the substantive articles on the allocation of taxing rights. The different provisions of the two models represent the different positions of residence-based taxation in favour of capital-exporting countries and source-based taxation in favour of capital-importing countries. Thus, the discussion below concentrates on the main differences in the substantive articles in the two models.

3.2.1.1 Permanent establishment (PE)

An enterprise resident in a treaty country is taxed in the other country only when the enterprise carries on business in that country through a permanent establishment (PE).

First, the OECD Model differs from the UN Model in two respects concerning respectively the PE in the case of contract engineering and the PE in the case of the supply of services, as provided in Article 5(3). The OECD Model contains only one paragraph concerning the PE in the case of contract engineering, stating that *"a building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months."* The UN Model contains two paragraphs. Unlike the OECD Model, the UN Model reduces the period from twelve months to six months in the first paragraph concerning the PE in the case of contract engineering. In addition, the UN Model provides for the PE in the case of the supply of services in the second paragraph, stating that *"the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned"*. The reason why the OECD Model does not include such a paragraph is that the supply of goods and services is treated equally in the OECD model. The China-France tax treaty concluded in 1984 (hereinafter: the old China-France treaty³³) followed the UN Model. Considering that China is still mainly a capital-receiving country, the revised China-France treaty in 2013 (hereinafter: the new China-France treaty³⁴) retains the second paragraph

³³ The Agreement between the Government of the People's Republic of China and the Government of the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, signed on 30 May 1984.

³⁴ The Agreement between the Government of the People's Republic of China and the

of the UN Model, but modifies the first paragraph by extending the time period from six to twelve months as provided in the OECD Model. The China-Uganda tax treaty concluded in 2012 (hereinafter: the China-Uganda treaty),³⁵ which has not yet entered into force, follows the UN Model.

Secondly, the OECD Model differs from the UN Model in cases in which an agent is deemed to be a PE, as provided in Article 5(5). The UN Model provides in Article 5(5)(b) that a person is deemed to be a PE also in cases in which *"the person has no [...] authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise"*. The OECD Model does not allow for this case. The old China-France treaty followed the OECD Model and both the new China-France treaty and the China-Uganda treaty continue to follow the OECD Model.

3.2.1.2 Business profits

An enterprise resident in a treaty country is taxed in the other country by way of its PE only where the related profits are attributable to the PE.

First, the OECD Model differs from the UN Model in respect of the principle according to which the profits are attributable to a PE, as provided in Article 7(1). The OECD Model adopts the economic connection principle and the UN Model adopts the force of attraction principle, given that according to the UN Model, the attributable profits include the profits that are attributable to *"(b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; (c) other business activities carried on in that other State of the same or similar kind*

Government of the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, signed on 26 November 2013.

³⁵ The Agreement between the Government of the People's Republic of China and the Government of the Republic of Uganda for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, signed on 11 January 2012.

as those effected through that permanent establishment". The old China-France treaty followed the OECD Model and the new China-France treaty and the China-Uganda treaty continue to follow the OECD Model.

Secondly, the OECD Model differs from the UN Model in respect of limits on deduction, as provided in Article 7(3). The (pre-2010) OECD Model provides that *"In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere"*. The UN Model additionally provides that *"no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission, for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the permanent establishment"*. Undoubtedly, the UN Model is more restrictive. The old China-France treaty complied with the UN Model, but both the new China-France treaty and the China-Uganda treaty follow the OECD Model.

3.2.1.3 Rates of withholding taxes

Dividends, interests and royalties can be taxed by means of withholding taxes by the source countries of these incomes. On these incomes, although the residence countries always have an obligation to provide relief from double taxation, the source countries generally apply a lower rate than that provided in domestic tax laws for the same purpose.

First, the OECD Model differs from the UN Model in respect of dividends, as provided in Article 10(2). The OECD Model provides that *“the tax so charged shall not exceed: a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends; b) 15 per cent of the gross amount of the dividends in all other cases”*. Although the UN Model permits split rates for direct dividends and portfolio dividends, it leaves the specific rates blank and requires the shareholder to hold at least 10% of the capital of the company paying the dividends, lower than the 25% of OECD Model, in order to apply the lower rate. The old China-France treaty did not envisage split rates, but a single rate of 10%. A single rate of 7.5% is applied also in the China-Uganda treaty. However, the new China-France treaty follows the OECD Model and envisages split rates, with the higher rate reduced from 15% to 10%³⁶.

Secondly, the OECD Model differs from the UN Model in respect of royalties, as provided in Article 12(1). The OECD Model provides exclusive jurisdiction for the residence country, stating that *“Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State”*. The UN Model permits the source countries to impose a withholding tax at a rate negotiated between the Contracting States. Considering in particular that China has always been an importer of technology, as the old China-France treaty provided in following the UN Model, the new China-France treaty envisages a rate of 10% when the source country imposes a withholding tax on all royalties³⁷. The China-

³⁶ Article 91 of the Regulations on the Implementation of 2008 Law on Enterprise Income Tax provides a rate of 10% with respect to withholding tax on dividends, interests and royalties received by a non-resident.

³⁷ On the other hand, the China-UK tax treaty (revised in 2011) and the China-Germany tax treaty (revised in 2014) provide a rate of 6% for rents from industrial, commercial or scientific equipment. For an analysis of new China-UK treaty, see C. WEI, *The China-United Kingdom Income Tax Treaty (2011)*, Bulletin for International Taxation, June, 2013, pp. 271-279. For an analysis of the new China-Germany treaty, see H. YANG and L. RUOLIAN, *Analysis*

Uganda treaty follows the UN Model and envisages the same rate.

3.2.1.4 Capital gains

The capital gains in Article 13 of tax treaties refer mainly to gains from the disposal of immovable property, movable property forming part of the business property of a PE, special movable property, such as ships, aircraft or boats, and shares. Taxing rights on capital gains are generally attributed to residence countries, and source countries have taxing rights only in cases in which the defined conditions are satisfied.

First, the OECD Model differs from the UN Model in respect of gains from the alienation of shares. The OECD Model provides in Article 13(4) only that *"Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State"*. The UN Model additionally provides in Article 13(5) that *"Gains, other than those to which paragraph 4 applies, derived by a resident of a Contracting State from the alienation of shares of a company which is a resident of the other Contracting State, may be taxed in that other State if the alienator, at any time during the 12-month period preceding such alienation, held directly or indirectly at least ___ per cent of the capital of that company"*. Thus, unlike the OECD Model that provides one case, the UN Model provides two cases in which source countries have taxing rights. The old China-France treaty followed the UN Model and the new China-France treaty still follows the UN Model, but the China-Uganda treaty follows the OECD Model.

Secondly, although the OECD Model and the UN Model are identical in respect of miscellaneous provisions providing exclusive jurisdiction for the

of New China-Germany Tax Treaty, International Taxation in China (Journal in Chinese), 7/2014, pp. 38-42.

residence country, stating lastly that gains from the alienation of any property, other than that referred to in the paragraphs above, shall be taxable only in the contracting state of which the alienator is a resident, the old China-France treaty allowed the source country to impose tax on these gains, stating in Article 12(6) that "*Gains which a resident of a Contracting State derives from the alienation of any property other than that mentioned in paragraphs 1 to 5 above, may be taxed in the other Contracting State, if those gains are derived therefrom*". However, both the new China-France treaty and the China-Uganda treaty follow the OECD and UN Models, abolishing the taxing rights of the source country in miscellaneous provisions, and undoubtedly China has adopted the residence country position in this respect.

3.2.1.5 Independent personal services

As the UN Model provides, the OECD Model dealt with the allocation of taxing rights on incomes from independent personal services in Article 14, by conferring the taxing rights on the source country in two cases in which the resident of a contracting state has a fixed base regularly available to him in the other contracting state (source country) for the purpose of performing his activities or his stay in the other contracting state for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned. However, the OECD Model, according to which there is no substantial difference between the PE and the "fixed base" above, has deleted Article 14 and deals with incomes from independent personal services in the PE provision. Considering that China is still mainly a service-receiving country, not only did the old China-France treaty follow the UN Model, but the new China-France treaty and the China-Uganda treaty also follow the UN Model.

3.2.1.6 Other income

Income not dealt with specifically in any articles of a tax treaty is known as "other income". As regards other income, the OECD Model provides exclusive jurisdiction for the residence country, whereas the UN Model permits the source country to impose tax on these incomes arising in the source country. The old China-France treaty followed the UN Model, allowing the source country to share the right to tax other income, stating in Article 21(1) that "*Items of income of a resident of a Contracting State not dealt with in the foregoing Articles of this Agreement and arising in the other Contracting State may be taxed in that other Contracting State*". However, in following the OECD Model, the new China-France treaty deletes this paragraph, and the China-Uganda treaty does not include this paragraph.

3.2.2 Anti-abuse article and procedural articles on administrative cooperation and arbitration

In addition to the substantive articles on the allocation of taxing rights, the other important articles provided in tax treaties include anti-abuse and procedural articles on administrative cooperation and arbitration. Although these articles may not incorporate the different positions of two models in favour of the source country or the residence country, for a comprehensive understanding of the developments of China's tax treaties, it may be useful to briefly introduce also the changes of China's tax treaties in these articles in accordance with the latest OECD and UN Models.

3.2.2.1 Anti-abuse

With the recognition in the OECD Model Commentary that anti-abuse is one of the aims of tax treaties, the anti-abuse article as a miscellaneous rule is added in the China's revised tax treaties such as the new China-France

treaty, that states in Article 24 that *“The benefits of any reduction in or exemption from tax provided for in this Agreement shall not be available where the main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions of this Agreement.”* The anti-abuse article is based on the “purpose test” rule and a similar provision is added also in articles dealing with dividends, interests and royalties. Moreover, due to the exclusive jurisdiction assigned to the residence country, also the article on other income has introduced the purpose test rule, in particular in order to avoid the phenomenon of double taxation³⁸. But no anti-abuse article or provisions are provided in the China-Uganda treaty and one possible reason is that China is a capital-exporting country with respect to Uganda, and the fiscal revenue of the source country is more influenced by tax treaty shopping (abuse).

3.2.2.2 Exchange of information

As an important means of administrative cooperation, the exchange of information between the tax authorities of treaty partners has special meaning for combating international tax evasion. Thus, tax treaties are developed in order to facilitate the exchange of information mainly in two respects. First, as regards the scope of information, according to Article 25(1) of the old China-France treaty, the contracting states shall exchange such information as is necessary for carrying out the provisions of the Agreement or of the domestic laws of the Contracting States. By following the latest OECD and UN Models, Article 27(1) of the new China-France treaty replaces “necessary” with “foreseeably relevant”. This change can

³⁸ F. LIZENG, *Analysis of New China-France Tax Treaty*, International Taxation in China (Journal in Chinese), 1/2014, p. 40.

enlarge the scope of information to be exchanged. Also Article 26(1) of the China-Uganda treaty uses the words “foreseeably relevant”. Secondly, as regards situations where a refusal to exchange information is not permitted, in following the latest OECD and UN Models, the new China-France treaty in Article 27(4) and (5) adds two situations in which the contracting states cannot refuse to supply information: 1) cases in which the contracting states may need such information for their own tax purposes; 2) cases in which there is a claim to bank secrecy. The China-Uganda treaty includes the same provisions. Undoubtedly, these two situations where a refusal is not permitted can extend the scope of the information to be exchanged.

3.2.2.3 Assistance in the collection of taxes

In terms of recent innovations in administrative cooperation, assistance in the collection of taxes is included in the new China-France treaty in Article 28, following the latest OECD and UN Models, stating that “*The Contracting States shall endeavour to lend assistance to each other in the collection of revenue claims. The competent authorities of the Contracting States may by mutual agreement settle the mode of application of this Article*”. However, the China-Uganda treaty does not include this article. It should be noted that in 2013 (23 August) China signed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, though the Convention has not yet entered into force.

3.2.2.4 Arbitration

In the case of unresolved disputes relating to the application of tax treaties, Article 25(5) of the OECD Model provides for mandatory arbitration if the competent authorities of the two contracting states are unable to reach an agreement. In this respect, the UN Model provides two alternative versions.

Alternative A reproduces Article 25 of the OECD Model with the addition of a second sentence in paragraph 4 but excludes arbitration. Alternative B is formulated in the same terms as alternative A, but includes mandatory arbitration. However, by following alternative A of the UN Model, neither the new China-France treaty nor the China-Uganda treaty provides for arbitration in the case of unresolved disputes. It may be that China does not yet have full trust in international arbitration, as arbitration practitioners come mainly from the developed countries. However, at some time in the future China may decide to include arbitration in China's tax treaties. Considering that there are some drawbacks with respect to traditional dispute resolution (by negotiation) and arbitration is seen as a new form of dispute resolution widely adopted by developed countries, arbitration should only be supplementary, not alternative³⁹.

4. Conclusions

The Third Plenary Session of the 18th Central Committee of the Communist Party of China (November 2013) pointed out formally for the first time that *"Finance is the foundation and an important pillar of state governance. Good fiscal and taxation systems are the institutional guarantee for optimizing resources allocation, maintaining market unity, promoting social equity, and realizing enduring peace and stability"*⁴⁰. As a result, taxation is no longer seen solely as an instrument of economic reform, but as an important instrument of state governance in China. In terms of public policy, taxation is no longer seen solely as an economic concept and is not simply related to economic development, but it has assumed more public functions, i.e. those related to democratic politics, social equity and environmental

³⁹ S. ZHULI, *Legal Assumption towards Inserting Arbitration Clause in Sino-Foreign Tax Treaties*, Journal of Shanxi Finance & Taxation College (Journal in Chinese), 1/2012, p. 31.

⁴⁰ See Communiqué of the Third Plenary Session of the 18th Central Committee of the Communist Party of China.

protection. Moreover, the Session put forward the requirement on implementation of the principle of statutory taxation. On 15 March 2015, China adopted a revision for the first time to the 2000 Legislation Law as a constitutional law, and the revised law underlines the principle of statutory taxation by singling it out in a provision, and makes it clear that a tax can only be levied and tax rates set with the endorsement of the law. Undoubtedly, these changes are more important than economic development as an end in itself and will have a profound impact on China's tax legal system. As a result, a more significant change in the effectiveness and developments of tax treaties in China's legal (tax) order may take place in the near future.