International Tax Policy: The Counter-Story
Presented by the BRICS

Kim Brooks
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17.1 Introduction

International tax law has evolved rapidly around the world over the last one hundred years. Legislation, case law, and administrative practice have at times developed in a coordinated and policy-grounded fashion. At other times, changes might be explained more by the particular and specific pressures of a moment. Despite significant differences in the policy directions of jurisdictions, all jurisdictions confront the same, fundamental tax policy decisions and many of the same pressures.

This chapter focuses on the international tax policy directions of Brazil, Russia, India, China, and South Africa (BRICS). Scholars like Reuven Avi-Yonah have argued that there is sufficient coherence to international tax law that it forms part of international law.1 The BRICS countries present something of a counter-story to the narrative that international tax law has harmonized. These five countries, major economic and trade players in the world but not members of the Organisation for Economic Co-operation and Development (OECD), have developed their international tax policy with an eye to the approach suggested by the OECD, but not necessarily in conformity with its strictures. Over the last twenty years the BRICS have been mentioned in tandem and they have taken modest steps to confer with one another. Yet, their political, economic, and social contexts are different. Given their increasing role as both sites of commercial expansion and their power as exporters of resources and capital, it seems they might be natural international tax policy allies.

This chapter explores the international tax policy directions of the BRICS jurisdictions under the familiar, broad heads of international tax policy: jurisdiction to tax, double tax relief, anti-avoidance measures, and exchange of information.2 A complete review of the international tax policy directions of

2 The BRICS countries work together on at least some of these areas of international tax policy. See e.g.
any one of these jurisdictions on its own could easily become a book. As a result, the chapter focuses on providing a general and comparative overview, based on the material provided in the chapters presented earlier, and is centred on income taxation.3

17.2 Jurisdiction to Tax: Defining a Country’s Tax Reach

All countries that impose an income tax do so on the basis that income has a source in the jurisdiction. In other words, it is widely accepted that where a taxpayer receives income from activities with a connection to a jurisdiction, that jurisdiction has a justifiable claim to tax the related income. Most countries also impose an income tax on the basis of the residence of the taxpayer. Where a taxpayer has a sufficient economic connection to the jurisdiction (to be resident there), the jurisdiction may impose an income tax on the income of the taxpayer, often regardless of where the income has its source.

Each country needs to make a policy judgment about the parameters of its tax reach within that broad framework: Will it tax residents on their worldwide income? What types of income will be subject to tax at source? How will the jurisdiction know that a particular income return is sourced in the country? A long list of factors inform the policy judgement call made on each of these issues: how effective is the jurisdiction’s tax administration, how much inbound and outbound investment occurs, what is the nature of inbound investment — does it take the form of investment in manufacturing, services, or natural resources, for example.

In the main, the concept that captures when an individual or corporation has sufficient economic nexus with a jurisdiction to be considered taxable on income, possibly on a worldwide basis, in that jurisdiction is the concept of “residence”. While other

concepts of country allegiance are occasionally adopted by countries to reflect a strong political (citizenship) or intentional (domicile) association with the jurisdiction, most countries in the word have, as a policy matter, chosen residence as the operational concept. The indicia of residence (a strong economic nexus) vary by jurisdiction. For individuals, many countries choose to use a “facts and circumstances” test that attempts to determine and weigh the degree of an individual’s connections with the country. For companies, most jurisdictions use an incorporation or a central management and control (an often rough-and-ready, relatively basic facts and circumstances text) test for residence. Once a taxpayer has been determined to be a resident, the next question is what scope of income should be taxed in the residence state. Some countries choose to tax all income, no matter where earned (worldwide), while others focus only on income with a source in the country (territorial). Practically speaking, most countries adopt something in between those two extremes. Certainly, high income countries, who served as the starting homes for multinational businesses, tended to adopt residence-based taxation, which provided them with the ability to capture (for tax purposes) some of the revenue associated with activities with a source in lower-income countries.

The BRICS countries, very generally, have a mixed history with worldwide versus territorial systems. For example, beginning in 1995, Brazil moved from a largely territorial system, to a system of worldwide, residence-based taxation.\(^4\) At this point in their histories, all of the BRICS countries have adopted a system of world-wide taxation, based on the residence concept. Brazil’s evolution to a worldwide system of taxation reveals something fundamental about not just Brazil, but the general orientation of all of the BRICS countries: they each prioritize taxation at source, in spite of moves to tax the income of residents no matter where it is earned. At least some of the BRICS countries face a going-forward dilemma. While they have at least historically been capital importing countries, now all of the BRICS jurisdictions have at least a few major trading partner countries with whom they are the capital exporting jurisdiction. The challenge of designing an approach to international taxation that best preserves the ability of the BRICS to raise badly needed revenue is not necessarily clear.

In setting the scope for source taxation, countries need to decide on the geographic source rule on which they will rely. Formal geographic source rules are comparatively straightforward: they set the geographic source of income in a way that is administratively feasible. For example, the geographic source rule for dividend payments is often the residence of the payor. Alternatively, source rules can aspire to identify the location where the economic value was produced. To illustrate, a geographic source rule might require identifying the place where a royalty is used and where the technology was developed and allocating some portion of the returns to each jurisdiction.

Brazil’s domestic source rules vary in their use of formal geographic source rules and rules that find their inspiration in the location of the creation of economic value. For example, in taxing income from services, Brazil taxes income based on the source of payment (rather than, for example, the location of production and provision of the services). Similarly, South Africa’s domestic source rules rely on determining the place of the originating cause of the income, which generally has required a substantive inquiry into the place where the main activities were performed that give rise to the income.

Having raised the thorny issues of how to appropriately balance source and residence-taxation, and recognizing that all BRICS countries value the imposition of source taxation, this chapter turns to discuss the issue of how much of a country’s source jurisdiction should be ceded in bilateral tax treaties. While tax treaties might serve a number of purposes, in the context of capital importing jurisdictions, the most important result of a tax treaty is that the source jurisdiction sacrifices some of its taxing jurisdiction. The mechanisms for enabling the sacrifice of source taxation might be broadly classified into two types. First, the source jurisdiction sometimes sacrifices its taxing rights by raising the threshold for taxation. For example, most countries impose tax on the activities of a person or entity when it carries on business in the jurisdiction. Tax treaties raise that threshold for taxation and require that the entity has a “permanent establishment” in the jurisdiction. Second, source jurisdictions might set maximum rates of tax to be levied on particular types of payments. So, for example, in domestic law a country might impose a 30 percent gross withholding tax on royalty payments. It might agree to reduce that rate to 10 percent by treaty.

Each of the BRICS countries has decided to enter into at least some bilateral tax treaties. Brazil has the smallest number of treaties in force: 36. This suggests that Brazil has been the
most cautious in agreeing to sacrifice source-based tax revenue of the BRICS jurisdictions. In contrast to the Brazil’s slower expansion of its tax treaty network over forty or so years, China entered into its first bilateral treaty in 1983 and since then has entered into 98 more; South Africa has 74 tax treaties in force, almost all of which were signed after 1994; India signed its first treaty in 1958 and has negotiated 98 treaties; and Russia has negotiated 88 tax treaties. The policy considerations relevant for BRICS countries in deciding to enter into tax treaties are likely more complicated than for other categories of countries. For BRICS countries, at least historically, entering into tax treaties would have meant sacrificing source-based tax revenue (because they were capital importing countries with most treaty partners). As noted above, over time, as BRICS countries have gained economic power, the story is less clear. In many instances, BRICS countries might now be the capital exporter in a treaty relationship.

As is obvious already, Brazil’s history is particularly poignant. Given that Brazil historically had a territorially-based tax system, there was no advantage (in terms of the revenue results) to entering into a tax treaty. Since it did not impose a tax on its residents’ world-wide incomes, Brazil would only be sacrificing revenue to its treaty partners if it entered into tax treaties. In this era, Brazil nevertheless undertook some treaty negotiations, often with the aspiration of negotiating a tax sparing provision that it hoped would facilitate investment in Brazil. Most famously, Brazil negotiated a tax treaty with the United States in the 1960s that was not ratified by the U.S. Senate largely because of the presence of the tax sparing provision.

A detailed review of the tax treaty policy of the BRICS is provided in Chapter X. This chapter reviews the tax policy reflected in the decision to sacrifice tax revenue on business profits and investment returns reflected in the tax treaties of the BRICS countries. Business profits and investment returns were chosen because they illustrate the two main approaches to source-taxation revenue-sacrifice: a rise in the threshold for taxation and a limit on the rate.

17.2.1 Sacrificing tax revenue on business profit

Tax treaties reduce the taxation of business income by source states. They generally do this by elevating the threshold for business taxation. All double tax treaties employ the

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5 See Schoueri in our tax and development book perhaps
“permanent establishment” threshold concept. Put simply, business activities are not subject to tax at source until the activity is carried on through a permanent establishment: a fixed place through which the business is wholly or partly carried on. Given the “fixed” and tangible nature of the kinds of places identified in the permanent establishment article, and given the change to the provision of valuable resources and assets of a less tangible and permanent nature, it is widely accepted that the permanent establishment threshold is set at a higher level now than might have originally been intended when more business was carried out through, for example, an office with some physical permanence. The main policy question for countries that are willing to sacrifice some of their taxing rights by raising the threshold for business taxation is how high to raise that threshold. There are myriad additional policy questions, of course, including the extent to which deductions should be allowed in calculating business profits and whether once a non-resident business has sufficient activity in the jurisdiction to pass the threshold other activities of that non-resident in the jurisdiction should be taxed even if they are not clearly connected to the threshold-passing business.

The OECD model treaty contains a definition of “permanent establishment” in article 5. That article provides an extended list of illustrations of activities that constitute a permanent establishment. For example, the list includes physical sites that constitute a permanent establishment (e.g. a quarry or an office) and periods of time (12 months) a building site or construction or installation project must continue to be found to be a permanent establishment. Each of the items on the list might be adjusted by treaty partners in negotiations to either elevate or lower the threshold at which business profits will be subject to tax in the states party to the treaty. In the main, each of the BRICS countries has at least some treaties that lower (from the OECD model) the threshold for activities to be considered permanent establishments (and therefore taxable at source). It seems possible to say that the BRICS share a tax policy that mitigates in favour of the United Nations (UN) model definition of permanent establishment, at least in some instances. In other words, because of the sense that source taxation is more important in BRICS states than in higher-income countries, the BRICS countries tend to favour, in at least some cases, the adoption of provisions from the UN model, which preserves greater scope for taxation at source.

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In domestic law, Brazil taxes business activities below the permanent establishment threshold. Some of this taxing jurisdiction is ceded in Brazil’s tax treaties, which employ a mix of OECD and UN model terms. For example, some of Brazil’s treaties list additional kinds of physical establishments within the definition of permanent establishment, including a warehouse, factory or oil rig. The period of time necessary for an activity to be considered a permanent establishment is sometimes reduced from 12 to 9 or 6 months. It might be noted that the scope of the permanent establishment article in the Brazilian context is likely narrower than in other jurisdictions given that Brazil generally deems a foreign branch to be a Brazilian entity, removing the need for reliance on the permanent establishment concept.

Russia has a permanent establishment concept in its domestic legislation, with a lower threshold for taxation at source than the OECD model treaty. For example, Russia’s tax legislation does not require a time period before a building site becomes a permanent establishment. Many of Russia’s treaties, however, accept the OECD model. Following the building site example, to illustrate, many of Russia’s treaties adopt the United States suggestion of 12 months.

India regularly leans toward the UN model in the design of its permanent establishment article. For example, India’s treaties often include a service permanent establishment provision that deems a service provider to be a permanent establishment after a threshold period of 3, 6, or 9 months, for example, expires. India also reduces the period of time before a building site becomes a permanent establishment from the suggested 12 month period to 9, 6, or 3 months and defines permanent establishment more broadly in some cases to include physical structures like a dredging project or a drilling site.

China has incorporated permanent establishment articles in its tax treaties and offers an explanation of the concept in its circular for the determination of permanent establishments and other tax treaty matters. Generally speaking, China

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8 For an extended discussion of the permanent establishment concept in China, see Cassie Wong, Matthew Mui and Alan Yam, “China” in Ekkehart Reimer et al, Permanent Establishments (The
incorporates aspects of the definition of permanent establishment reflected in the UN Model Convention, although it borrows from both the UN and OECD Models. For example, some Chinese treaties include in the definition of permanent establishment assembly and supervisory activities which last more than 6-months (a shorter period than the 12-months recommended by the OECD); the provision of services where the duration exceeds 183 days; and an installation, drilling rig, ship or structure used for the exploration or exploitation of natural resources for a period of more than six months.

South Africa generally follows the OECD model in its design of the business profits and permanent establishment articles; nevertheless, in a few key instances aspects of the UN model are incorporated. Sometimes South Africa negotiates for a shorter period of time for a building or construction site to be considered a permanent establishment; takes the view that the furnishing of consultancy services for a period of more than six months within a twelve-month period constitutes a permanent establishment; and deems an enterprise that conducts activities related to exploration or exploitation of natural resources to be a permanent establishment if it exists for more than six months.

In addition to lowering the threshold for when an activity might constitute a permanent establishment (by adjusting the definition in article 5), some BRICS countries have negotiated more preferential source taxation in the business profits article (article 7). Specifically, in at least some treaties, BRICS countries have negotiated to follow the UN model treaty in two respects. First, in some treaties, once an enterprise has a permanent establishment in a jurisdiction, the treaty enables the source country to tax all of the income the enterprise derives in that jurisdiction. This is generally referred to as a source of attraction rule. Second, an enterprise might dramatically reduce its profits taxable in the source state by allocating a range of deductions to the permanent establishment. In some cases, BRICS countries have negotiated to restrict the deduction of some expenses, for example, head office or administrative expenses, in the calculation of the profit of the permanent establishment. Russia, with a very few exceptions, does not include force of attraction clauses in its treaties, neither does China. India, on the other hand, has at least a few treaties that include the force of attraction rule (although none of the more recently negotiated treaties include the

provision), enabling the taxation of profits from sales of a similar kind as those sold through the permanent establishment or from similar business activities.\(^9\)

In some cases, tax treaties limit the deductibility of expenses by a permanent establishment. For example, as a general matter, Brazil does not include the provision from the OECD model treaty that allows a permanent establishment to deduct executive and general administrative expenses.\(^10\) Similarly, India has some tax treaties (but not the majority) that do not include the OECD model’s permissive language on the deduction of expenses.\(^11\) China’s approach to deduction of expenses is mixed: where the treaty partner is a developed country the scope of deductions is limited; where the treaty partner is developing, the scope of deductions is often more expansive.

In addition to these adjustments to articles 5 and 7 to enable greater scope for source taxation and to facilitate taxation of more income once a business is determined to have a permanent establishment, BRICS countries have grappled with the challenge of taxing income associated with digital activities. The OECD has been slow to adapt the permanent establishment definition to include digital and electronic business within its scope, with the effect of ensuring greater taxing scope for residence states. To some extent, BRICS countries have been able to press for greater taxation in this area through the lens of technical services, discussed in more detail below.

17.2.2 Reducing the tax rate on investment income

Generally speaking, countries tax investment returns at a flat rate on the gross payment. The rationale is simple: it is difficult to audit foreigners’ tax returns and often investments have no real physical location that could be seized by a domestic tax authority seeking to enforce the tax due. Three international tax policy judgements related to the taxation of investment are explored in this chapter. First, the decision about the maximum rate of withholding to agree to in negotiating

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a tax treaty (which limits the source-tax on investment returns). Second, the decision about how to define the scope of the royalties provision and specifically, whether technical services should be included under the royalties or the business profits articles. Third, the approach to the geographic source rule, which defines the reach of the tax system, and specifically, should the test for whether a revenue stream has a source in the country be the residence of the payor or a more economically-based rule that looks to the place that causes the value to arise.

For the most part, BRICS countries reserve the right to agree to withholding tax rates in excess of those suggested by the OECD, particularly on the royalties article where the OECD suggests a 0 percent withholding tax rate. Speaking very generally, in the earlier days of treaty negotiations, the BRICS countries had more divergent policies, with some countries negotiating rates higher than those recommended by the OECD and others agreeing to rates below the OECD’s recommended levels. More recently, the countries have cohered around rates, although it is hard to discern a shared policy. Brazil’s tax treaty policy generally retains more scope for source-based investment taxation than countries who draw on the OECD model. At least in its early stages of treaty negotiation, Brazil was likely to maintain a withholding tax rate on investment income that was higher than that recommended by the OECD. Generally speaking, the rate was not reduced below 15%. In contrast, Russia agreed to a large number of treaties with 0 percent withholding tax rates on interest or royalties in its earlier days of treaty negotiations. More recently, it has negotiated positive withholding tax rates on all investment returns. Although historically India negotiated higher withholding tax rates on investment income (whether dividends, interest, or royalties), it has more recently agreed to lower withholding tax rates.12 Russian tax treaties tend to use relatively low withholding tax rates — normally under 15 percent — for all sources of investment income.13 South Africa has sought to renegotiate its treaties with 0 withholding tax rates on dividends, interest, and royalties in an effort to shore up source-based taxation of these investment returns.

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An international tax policy problem of concern for capital-importing countries is the tax treatment of technical assistance and services. These kinds of services can escape source-tax when the standard OECD model treaty provisions are adopted. Brazil has tended to press for inclusion of technical assistance within Article 12 (the royalties article) to ensure that at least some withholding tax is exacted on payments for technical services. Where a service is found not to fit within the royalty article, the Brazilian administration often takes the position that it falls within Article 21 (other income) and should be taxed at source. Generally speaking, India’s treaties include a separate clause on technical services in the royalties article. In a few cases, a separate technical fees provision has been negotiated. In the light of a significant amount of litigation around the scope of the royalties clause, India has clarified in its domestic legislation that it considers royalties to include the transfer of all or any rights in respect of property or information, including the use or right to use a computer software. China, like Brazil and India, has concerns about the ability of large technical services fees to escape source country taxation, but has not taken steps to include technical fees under the royalties article. Nevertheless, China does try in its tax treaties to interpret royalties broadly to include at least some technical fees and it imposes a positive withholding tax on royalty payments. In contrast to the other BRICS countries, South Africa has taken a narrower view of the services that might fit within the royalties provision and characterizes most services as subject to net tax under the business profits articles. However, South Africa takes an economically-based approach to its determination of the source of the payment. Generally, it views technical services as provided in the place where the service is rendered (and not the place of the payor). This approach can create conflicts, for example, where a South African country provides consultancy services to a subsidiary elsewhere in Africa. In those circumstances, South Africa takes the position that the income has its source in South Africa (because that is where the service is rendered) and the other country may take the position that the income has the source there (because that is where the payment for it is made).

Before concluding this section on the international tax policy reflected in the BRICS approach to defining their tax scope, it

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might be worth drawing attention to their approach to the residual provision in their tax treaties, article 21, which covers income not otherwise covered by the treaty. The OECD model treaty assigns the right to tax “other income” to the residence state. In contrast, the UN model preserves source country taxing rights. India’s treaties generally grant the source state the right to tax items of income not dealt with elsewhere in the treaty. Brazil has similarly asserted the source jurisdiction’s right to tax other income under Article 21, as have China and South Africa. Not only does this approach to Article 21 change its default allocation of taxing rights, but also it creates an incentive for BRICS countries to argue in favour of including a wider scope of income within the “other income” article.

17.3 Double Tax Relief: Facilitating International Coordination of Tax Regimes

Given that two (or more) jurisdictions may claim that a particular income return has its source in those jurisdictions, that two (or more) jurisdictions may claim that a particular taxpayer is resident in those jurisdictions, or that both a residence and a source state may seek to tax the same income return, all countries have developed some mechanisms for providing relief from double taxation.

Countries vary in the mechanism they use unilaterally in domestic legislation to alleviate international double-taxation. Some countries employ a deduction method (allowing resident taxpayers to deduct the taxes paid to foreign governments), some employ an exemption method (by not taxing foreign-sourced income), and others use a credit method (allowing resident taxpayers to claim a credit for taxes paid to a foreign country). Each of the BRICS countries has decided to unilaterally provide relief from double taxation by offering a foreign tax credit.

Tax credit mechanisms require the residence state to provide credit to its resident taxpayers for taxes paid to the source state (usually with a limit: the rate of tax in the residence state). This domestic method of relieving taxes, therefore, privileges the source state’s ability to tax. However, where the source state chooses not to impose a source-level tax, then the residence state is able to impose its full taxing

jurisdiction on that income. As a result, in at least some cases, where a source state attempts to offer a tax incentive to investment by not taking income at source, the potential incentive effect of that policy decision is eroded because the residence state simply taxes the income earned.

All of the BRICS countries have negotiated at least some tax treaties with tax sparing provisions, provisions designed to alter this conventional relationship between source and residence state tax systems. Tax sparing provisions enable the capital importing country to offer tax incentives to attract foreign investment without fear that the capital exporting jurisdiction will impose world-wide taxation on its resident with the result that the tax incentive becomes a transfer of tax revenue from the capital-importing to the capital-exporting states. In design, tax sparing provisions preserve the tax incentives granted by one jurisdiction (generally a capital-importing and lower-income jurisdiction) by requiring the other jurisdiction (generally a capital-exporting and higher-income jurisdiction) to give a tax credit for the taxes that would have been paid to the capital-importing country if the incentive had not been granted. Some scholars and tax commentators characterize these tax sparing provisions as tax expenditures (the equivalent of foreign aid) granted by high-income to low-income states; other commentators staunchly resist that characterization and frame tax sparing provisions as provisions that recognize the right of source (capital-importing) states to tax income with a strong economic connection to it (and to respect that right even in the absence of the imposition of tax).

Brazil has been the staunchest advocate for these kinds of clauses. At least in its earlier days of treaty negotiations, Brazil advocated for tax sparing provisions in its tax treaties, and sees these not as a means of achieving double tax relief, but rather as a method for incentivizing investment.16 In more recent treaty negotiations, Brazil has been less inclined to negotiate for or agree to tax sparing or matching credit clauses, likely because Brazil no longer sees itself primarily as a capital-importing nation.

The other BRICS jurisdictions also have at least some experience with tax sparing provisions. Russia has negotiated tax sparing provisions in at least a few treaties. India negotiated tax sparing provisions and matching credit provisions in well over

half of its tax treaties. However, in India’s recent treaty negotiations it has not sought or agreed to tax sparing provisions. China’s first tax treaty, with Japan, included a tax sparing clause in favour of China. A large portion of China’s tax treaties (roughly half) include tax sparing provisions of some kind. However, in 2009 China changed its policy and it has not negotiated tax sparing provisions in its tax treaties since then. Finally, although South Africa has negotiated tax sparing in a few of its treaties, its policy is not to ask for tax sparing provisions going forward.

Over time, all of the BRICS jurisdictions have moved away from negotiating tax sparing provisions, presumably because the case for incentivizing investment into the BRICS countries has diminished as has the number of treaty partners for whom a BRICS country would be the capital importer.

17.4 Anti-Avoidance Measures: Shoring Up Tax Collection

Historically, the main preoccupation of international tax policy was reducing the potential for international double taxation. Times have changed. The gaps between source and residence taxation, and the ability of taxpayers to develop intricate tax avoidance and evasion plans, have led to a flurry of interest in double non-taxation, or instances where taxpayers manage to pay little or no tax on international income. Countries have both acted unilaterally to protect their domestic tax bases and coordinated with other jurisdictions to shore up the international tax system more generally. Each of the BRICS countries have taken some steps to better protect their ability to tax international income, although those steps have not been taken in tandem or consistently across the four countries. This part of the chapter explores four anti-avoidance techniques: incorporating a limitation on benefits provision in tax treaties and adopting transfer pricing, thin capitalization, and controlled foreign affiliate regimes in domestic legislation.

17.4.1 Limitation on benefits

Tax treaties often include specific anti-avoidance rules to address opportunities to avoid tax that might arise in the

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context of an individual article; for example, the dividend article may include a provision that requires identifying the beneficial owner of the investment to ensure that taxpayers do not simply establish a legal owner in a residence jurisdiction to take advantage of a preferential withholding tax rate in between the treaty of that jurisdiction and the payor jurisdiction. Led by the United States’ practice, some treaties include a general limitation on benefits clause. The purpose of that provision is to restrict the use of the treaty where the main purpose of the transaction is to secure a treaty benefit in a way that is contrary to the object and spirit of the tax treaty. BRICS countries do not appear to advocate for limitation on benefits provisions, although they occasionally agree to them. Brazil has not negotiated a treaty with the full scope of the limitation on benefits clauses found in treaties negotiated by the United States. It has, however, negotiated at least three treaties that include a more general clause that limits treaty benefits. Russia has a couple of tax treaties with limitation on benefits provisions; however, it is not Russia’s practice to ask for that clause. India includes limitation on benefits provisions in some of its treaties, and China has included that provision in a couple of treaties.

17.4.2 Transfer pricing
Transfer pricing rules are designed to limit the ability of a multinational enterprise to manipulate the recognition of its profit, ideally shifting the allocation of that profit to low or no-tax jurisdictions. Generally, transfer pricing rules allow the government to adjust the prices charged between related entities with the aid of some appropriate benchmark. Enacting transfer pricing rules has become a fundamental plank in the tax policy options of countries seeking to shore up their domestic tax regimes: without a rule to stop related companies from shifting income “off shore”, the tax liability of resident taxpayers with non-resident related parties could relatively simply be reduced to zero.

Transfer pricing regimes require some method for allocating the income earned between the related parties. Most countries have adopted, at least formally, an “arm’s length method”. The theory is that prices charged between related entities should be the same as prices that would have been charged between independent and unrelated third parties.

BRICS countries have widely different approaches for applying and enforcing the arm’s length method. Speaking generally, the BRICS countries appear (like many countries in the world) to have faced some policy and pragmatic challenges with the theory and design of the OECD’s arm’s length approach. Brazil has had transfer pricing rules since 1997. It is quite distinct in its approach to auditing prices from related transactions. Instead of an arm’s length approach, Brazil generally employs formulas to allocate profits between related parties. Taxpayers are permitted to demonstrate that the predetermined rates deviate from practices of unrelated parties. Russia’s first version of its transfer pricing rules applied only where the prices deviated from market prices by 20 percent. In 2012, Russia revisited its transfer pricing legislation and it now applies the OECD approach. India introduced transfer pricing in 2001. India’s approach seems broadly consistent with the approach endorsed by the OECD. China adopted transfer pricing rules in 2008. Generally speaking, China’s rules adopt the arm’s length approach and follow the OECD transfer pricing guidelines. South Africa’s domestic legislation includes transfer pricing rules, enacted in 1995 and revised in 2013, that apply to enable the adjustment of payments between connected parties in the international context. In 1999 the South African Revenue Service issued a note that made it clear that South Africa planned to follow the OECD’s 1995 transfer pricing guidelines. The South African experience with transfer pricing aligns with many of the broader concerns about the challenges of an arm’s length approach, including the difficulty of finding comparable

prices, the challenges of determining whether a management fee is appropriate or reasonable, and the potential for applying overall mechanisms to ensure that the profit division between related entities is acceptable.

17.4.3 Thin capitalization

In most corporate tax regimes around the world, interest payments are deductible in calculating domestic profit, while dividend payments are not. The result is that corporations in higher-tax jurisdictions are motivated to seek debt investment and to over-leverage their activities. Thin capitalization rules impose some relatively arbitrary limit on the ratio of debt to equity in a firm’s capital structure. The result is that there are some limits on the ability of a company to reduce its taxes in a jurisdiction by paying out excessive interest.

The BRICS countries have, for the most part, included thin capitalization rules in their domestic legislation, sometimes with concerns about the interaction of those rules with their tax treaties. They have varied in making the policy judgement about the appropriate debt to equity ratio. Russia’s thin capitalization rules apply where the foreign company owns more than a 20 per cent stake in the capital of the company and a 3:1 debt to equity threshold is applied.\(^{25}\) India does not have thin capitalization rules. China adopted rules in 2008 that set a fixed ratio – 5:1 for financial institutions and 2:1 in all other cases.\(^{26}\) South Africa’s ratio is set at 3:1.\(^{27}\) South Africa has a noteworthy “headquarter company” regime, which grants headquarter companies an exemption from its CFC, transfer pricing, and thin capitalization rules, ostensibly as a means of encouraging the use of South Africa as a gateway to investment.

17.4.4 Controlled foreign corporation regimes

In 1962, the United States was the first country to enact controlled foreign corporation rules (CFC rules). Those rules

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seek to prevent the deferral of taxation by taxpayers who set up corporate entities in foreign jurisdictions and retain income in those foreign entities. CFC rules attempt to attribute that income back to the resident taxpayer in appropriate circumstances. CFC rules generally require passive income taxed at low rates to be taxed currently in the home jurisdiction. The rules, therefore, normally distinguish between passive and active income, and income earned in countries with higher and lower tax rates. Tax administrators make a range of tax policy judgements related to these distinctions and thresholds in the design of these rules.

Controlled foreign corporation rules are relatively new to BRICS countries and not all of the countries have adopted them. Brazil adopted CFC legislation in 2000. Its model varies from that adopted in many countries because Brazil taxes shareholders in all CFCs on all of the CFC income, without distinguishing between the type of income or the type of foreign tax system.28 India does not have CFC rules, although rules have been proposed. China adopted CFC rules in 2008.29 Those rules require determining whether the effective tax rate in the other jurisdiction is distinctly lower than the rate in China and determining whether the CFC has earned income mainly through active business activities. China also produces a “white list” of countries: if a CFC is located in one of those jurisdictions, the CFC rules do not apply. South Africa adopted rules in 1997. Those rules generally provide that where a South African resident has more than 50 percent participation or votes in a foreign company, the net income of the company is attributed to the resident in accordance with the resident’s interest.30

17.5 Exchange of Information: Facilitating International Tax Administration

28 Heleno Taveira Tôrres, “Brazil” IFA Cahier, 2010 Rome Congress, Tax Treaties and Tax Avoidance: Application of Anti-Avoidance Provisions, volume 95a (IFA, 2010) at 158. There was a court challenge to this at the Supreme Court – did it get resolved?
As cross-border commerce has increased, the ability of nation states to enforce their domestic tax rules has arguably become harder. In order to enforce tax liabilities, tax administrations need to be able to access information about the income of their residents and also of income with a source in their jurisdiction earned by taxpayers who are not resident. The tax jurisdiction of nation states imposes a geographical limit of a states’ enforcement powers to actors and property within the state. Agreements between countries to exchange tax information help overcome those international law limits. A number of policy issues have to be addressed in the design of tax information exchange, including: can information be exchanged spontaneously or automatically or only on request? Do bank secrecy laws restrict access to information about taxpayers’ bank accounts? Can lawyers or others invoke privilege over some information? Can the jurisdiction assist with collection?

The BRICS countries, like many countries in the world, have taken common steps to support information exchange. Each has been a signatory to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, although not all have formally ratified that convention domestically. Each includes a tax information exchange article in its bilateral tax treaties. Each has entered into at least some tax information exchange agreements (bilateral agreements that address only tax information exchange and not the fuller list of issues addressed in tax treaties). Beyond that, each country has some unique aspects to its approach to tax information exchange.

Brazil’s tax treaties include an information exchange article similar to, but not identical to, the OECD model. Brazil has negotiated a modest number of tax information exchange agreements. These agreements, with the exception of the one with the United States which took six years to ratify after negotiation, have not yet been ratified. Notably, the tax information exchange agreement with the United States does not require that Brazil (or the United States) ensure that authorities are able to obtain and provide information held by financial institutions. The issue of whether or not taxpayers’ bank data can be compelled under Brazil’s constitution remains live.

Russia’s network of bilateral tax treaties include the OECD-styled exchange of information article. Few of Russia’s...
bilateral treaties enable assistance in collection. Traditionally, tax authorities could not obtain information about individuals’ bank accounts; however, where the Russian tax authorities are acting on the request of a foreign tax authority, bank secrecy may be waived. For the most part, Russian exchange-of-information agreements do not enable automatic or spontaneous exchange of information, although there are some exceptions. Advocates have a commitment to keep information related to their legal assistance confidential.

India has agreed to the article on assistance in collection of taxes with slightly fewer than half of its treaty partners.\textsuperscript{32} India has entered into a large number of tax information exchange agreements, although these generally do not allow for spontaneous or automatic exchange of information. India has enacted domestic legislation to reduce the number of countries that do not agree to information exchange. The government of India has been provided with power to restrict deductions and impose higher withholding taxes, for example, where the other jurisdiction does not agree to an information exchange agreement. While generally banks are required to provide information, there are some exceptions where bank secrecy or other laws protect personal information. Lawyers do have a legal professional privilege over some information, however that privilege is overcome in the case of fraud.

All of China’s tax treaties include the OECD model exchange of information article. China’s laws allow it to collect a broad range of taxpayer information, including information held by financial institutions. China has negotiated tax information exchange agreements with additional countries.

All of South Africa’s double tax treaties include an exchange of information article, although not all of the articles are based on the OECD model.\textsuperscript{33} Generally, South African banks are required to keep client information secret; however, the general view is that tax administration is able to obtain bank information for tax exchange purposes. Lawyers may invoke professional privilege over confidential communication.


17.6 Conclusion: Prioritizing Goals

International tax laws are generally thought to assist a country to exact a fair share of tax revenue from cross-board trade and transit; to support equitable taxation of taxpayers; and to enhance its economic interests. As this brief review of the tax policy trends in the BRICS reveals, each jurisdiction strikes a different balance among the goals.

Perhaps not surprisingly, all of the BRICS countries are more likely to preserve source-taxation than higher income countries that adhere strictly to the OECD model tax treaty. They stake this ground in different ways in negotiating their bilateral tax treaties: sometimes by raising the threshold for the taxation of business income, sometimes by negotiating to increase the amount of income that might be allocated to a permanent establishment, sometimes by pushing for higher withholding tax rates on interest returns, often by trying to explicitly ensure that technical services may be taxed at sources, and usually by preserving source taxation of other income. Perhaps surprisingly, with the exception of Brazil, each of the BRICS countries have negotiated an impressive number of tax treaties: agreements that necessarily require the sacrificed of source-based tax revenue. In the future, one expects that the BRICS countries may revisit the sensibility of reducing their source jurisdiction by negotiating tax treaties that unduly restriction the taxation of business income and reduce the ability to tax returns to investment. Particularly in the light of the OECD’s initiatives to reduce base erosion, this is an opportune moment for BRICS jurisdiction, with their longstanding acceptance of the theoretical justifications for privileging source taxation, to lead a shift in the international consensus about the appropriate balance between residence and source taxation.

Using only the importance of negotiating a tax sparing clause as a metric, it seems that the BRICS countries have moved somewhat away from the importance of using the tax system as an incentive for particular types of foreign investment. Undoubtedly there will continue to be tensions between the need to raise tax revenue for public development and the aspirations of governments to attract foreign investment. The BRICS countries seem well positioned to resist race-to-the-bottom tactics for the design of their tax systems, however, given their significant markets and in some cases rich natural resources. The move away from the use of tax incentives seems appropriate.

The BRICS countries have taken steps, especially recently, to shore up their domestic tax bases. Most have adopted thin capitalization, controlled foreign affiliate, and transfer
pricing rules. The trend would suggest that in time, those rules will be common to the community. The transfer pricing rules appear to present both theoretical and pragmatic challenges for the BRICS, and working together to propose workable solutions to some of those challenges might be fruitful given the magnitude of the cross-border activity between BRICS jurisdictions and other countries. It is perhaps surprising that the BRICS countries do not appear to have been overly concerned about the abuse of tax treaties.

The BRICS countries have been willing to participate in international exchange of information initiatives, although with differing levels of commitment and different design features. Some pressures remain around disclosure of taxpayer information and spontaneous and automatic information exchanges. One expects that as the BRICS’ economic power increases, the ability to obtain information, and even more so agreements to assist with enforcement and collection of taxes, will gain in importance.

A review of the international tax policy decisions reflected in the tax treaty design of the BRICS countries is revealing. BRICS jurisdictions have, in the main, highly sophisticated tax systems that reflect the complex amalgam of their interests and needs. Their tax systems are, again generally, very much in transition. It seems that with some coordination, there is an opportunity for BRICS countries to lead a rich discussion and to help shape, and set, the international tax policy agenda for the next twenty years.