

Harmonization of tax and financial systems within BRICS

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Abstract

The modern world economy is characterized by such factors as capital mobility, intensification of production processes and cash flows. In such circumstances, it is particularly important for economic entities to understand all possible legal consequences of their operations. Financial policy should be formed by public legal entities, taking into account the guarantees of avoiding unjustified financial, economic and other barriers to the development of the world economy and international trade. The BRICS countries, which have a huge potential for building and developing close economic ties, have different and sometimes contradictory law enforcement and legislative approaches. Such contradictions are most acute in the tax sphere, currency, administrative and customs relations. The current international legal framework seeks to bring legal regulation closer to comparable or uniform rules.

Keywords: BRICS, tax system, financial system, economic cooperation, international payment card system.

JEL: F15, F42, F45.

Introduction

The process of convergence is significantly complicated by the existence of essential differences in the legal systems of the BRICS countries. This requires a more detailed and comprehensive study of further interaction and cooperation between the countries. The development of common rules for financial activities by the BRICS countries is also complicated by the disunity of approaches to legal regulation. The established rules of legal interaction between the BRICS member countries should be in accordance with the general international standards developed by the G20 and other institutions, as well

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as take into account the specifics of the legal systems of the BRICS member countries. The development of a unified legal approach to the regulation of international financial relations, as well as elimination of disputes arising from them, will contribute to a deep theoretical approach, which will take into account the current legal state and trends in the enforcement of national and international rules. Despite the existing specifics of tax and financial systems, the BRICS countries strive to influence the development of the global financial system. At the same time, developing a common position of the BRICS member countries on various issues is a rather complex process. This process should be accompanied by a deep scientific study.

The research is based on the normative legal acts of the Russian Federation, international authorities and agreements on public international trade and tax regimes. Special methods of scientific approaches were used: retrospective, systematic structural and dynamic analysis, observation and classification.

1. On integration of the tax and financial systems of the BRICS countries

Several large-scale BRICS financial projects are currently on the agenda. In particular, one of these issues is the need to create a new international payment card system and an independent rating agency.

The creation of the New Development Bank and a pool of contingent foreign exchange reserves is of particular importance. Such institutional reforms are a serious step towards further integration of the BRICS countries into the global financial system. The New Development Bank, which is being created as an alternative to the IMF, provides the BRICS member countries with a more rapid and flexible system for crisis response and investment in the most ambitious infrastructure projects (Lagutina, 2019).

The development of tax and financial relations between the BRICS countries and their enterprises requires not only selective “point-by-point” solutions to emerging financial issues, but also systematic harmonization of the tax and financial systems of the BRICS countries (on many aspects) (Rasoulinezhad & Jabalameli, 2018). Such harmonization can pose a number of challenges. In particular, the harmonization of the tax and financial systems of the BRICS member countries in certain areas (for example, in terms of indirect taxes) can serve as a condition for more in-depth cooperation in the legal and financial sphere contributing to the development of a unified legal approach to the regulation of financial relations, which can be presented at larger platforms. Such harmonization can become the basis for further development of economic relations between the BRICS member countries and their enterprises, even in the absence of special international treaties and direct BRICS agreements that would determine guarantees and conditions for a favorable international trade regime and other types of economic relations in these countries, taking into account the specifics of the economic and legal systems of the BRICS countries.

If harmonization is possible, it acts as a way to overcome unjustified financial, economic and other barriers to the development of the world economy and international trade. This

is particularly relevant in the context of the further development of BRICS. In addition, harmonization can lead to a convergence of legal traditions, becoming a condition for transforming political interaction between the BRICS countries into their economic cooperation using stable and reliable legal instruments. Obviously, if we are talking about the harmonization of the financial and tax systems of such large countries as BRICS, while having their own ideas about the priorities of their economic development, such harmonization is possible only in the context of certain aspects in which the interests of the countries coincide.

The most promising issues for discussion and further harmonization are the rules for indirect taxes on cross-border sales of works and goods in the BRICS countries. Harmonization is also possible with respect to approaches to direct taxation of cross-border income (profits) and property. But it should be coordinated with the work being done in this direction in the global format (OECD, G20). It should be borne in mind that with regard to the most important direct taxes (property tax, personal income tax, corporate income tax), the BRICS countries already have a network of bilateral agreements on the prevention of double taxation.

Of particular importance in the context of this issue is regulation of disputes arising from tax and economic relations with the use of mediation (alternative) procedures, as well as ensuring financial security, i.e. a system of countering tax evasion and compliance with the tax/financial legislation of the BRICS countries. The tax (financial) systems of the BRICS countries have their own specific features, but this does not exclude the possibility of improving and harmonizing many issues in the field of financial and legal regulation of cross-border economic relations in the light of the integration of the BRICS countries.

2. Areas of harmonization of the BRICS legal and financial systems

We identify a number of the most promising areas of harmonization of individual elements of the legal systems of the BRICS countries.

1. Further work is needed to improve certain legal aspects of the banking (financial) systems of the BRICS countries, including the practical aspect related to the formation of a unified payment system of the association. National payment systems (NPS) with their payment instruments are established and operate in virtually every BRICS country: in Russia — “MIR”; in China — “China UnionPay” (CUP); in Brazil — “Elo”; in India — “RuPay.” In South Africa, preparatory work is underway to create an NPS. Each country within BRICS can benefit from the creation of a common payment system of the BRICS countries. It should be noted that one of the most important features of foreign economic activity (including within the framework of BRICS) is that each state has to promote its services and goods to markets that are already occupied by transnational corporations. In addition to high operating profit, international payment systems have quite an impressive capitalization. By building a unified structure that works according to common rules and acts on the basis of common positions in negotiations with MasterCard, Visa and other

IPOs, not only a high overall capitalization is ensured, but also the best commercial result is achieved on the terms of accepting NMSPK plastic cards in third countries. The BRICS payment system can be implemented in the form of a joint-stock company (corporation) where the interests of all are ensured by a fair proportional distribution of shares in the authorized capital and where technological and technical balance is achieved.

2. Appropriate legal conditions should be created for harmonizing the tax systems of the BRICS countries in the field of taxation of cross-border economic transactions performed by economic agents (small and medium-sized businesses) through signing and further applying of the BRICS *multilateral convention* on the avoidance of double taxation with respect to certain types of income. Almost all BRICS countries have adapted and simplified tax regimes for small and medium-sized businesses. However, when entering the level of foreign economic activity, enterprises, even with a relatively small trade turnover, face the need to apply procedures for calculating taxes and avoiding double taxation. Such procedures are similar to those used by large multinational companies. In fact, this situation often becomes a barrier for small and medium-sized businesses to enter the international market. Such a situation may also create prerequisites for non-compliance with burdensome and unnecessarily complex legal requirements. To enhance economic cooperation and develop schemes for interaction with foreign partners within the legal framework, including at the level of medium and small businesses, the proposed international multilateral convention is aimed at applying the simplest method of eliminating double taxation (i.e. exemption), as long as the amount of taxable income from foreign investments in the relevant source country does not exceed a certain amount (for example, the amount equivalent to \$200,000). Contracting states may assume an additional obligation to provide guarantees that the tax rate in the country of residence of the investor will not exceed 15%. It seems that the adoption of a special convention will contribute to the further development of foreign investment and foreign trade between the BRICS countries at the level of small and medium-sized businesses, facilitating the regime of foreign economic activity of residents of the BRICS countries. In addition, the risks of multiple and double taxation of their income will be reduced; and prerequisites for expanding humanitarian cooperation in the fields of culture, science, sports, and education are already created.

3. Legal prerequisites should be created for forming common tax principles, as well as harmonized approaches to interpretation. The mechanism of tax arbitration and mediation in the field of cross-border taxation should also be developed. This is possible thanks to the signing and applying of the BRICS multilateral convention on the settlement of cross-border tax disputes. Business entities engaged in foreign economic transactions often face the need to regulate their tax obligations in the state of permanent location (the state of residence) and in the state where international trade or investment is carried out (the state of source). Bilateral agreements concluded between the BRICS countries contribute to the creation of a legal framework ensuring that such economic entities are not subject to double taxation in the source state and in the country of residence. Otherwise, there is a risk of lack of profitability for any foreign economic activity. However, in modern conditions, transactions between entrepreneurs are quite complex in their form (Ouattara,

2017). States often define their legal nature differently and interpret and apply bilateral tax agreements in different ways. In this case, the standard way for an entrepreneur to protect his rights is to appeal to the court of the country where, in his opinion, the international tax treaty was incorrectly applied and his interests were violated. But this usual way of protecting the rights of an entrepreneur does not work effectively enough when the positions of the two states (represented by the competent financial authorities and courts) where the entrepreneur carried out his activities clearly do not match. In some cases, in order to ensure regulatory certainty and guarantee the elimination of double taxation, an international decision on the agreed interpretation of the tax treaty concluded between the respective countries is required. At the moment, there is no arbitration or judicial body that has jurisdiction for such international cases. With few exceptions, WTO law does not apply to this category of disputes.

It appears that this convention will help to develop the BRICS agreed positions on the interpretation of international tax treaties from the point of view of the economy — facilitate international economic activity in the BRICS and in the political arena will help the BRICS to develop a common position on resolving this type of disputes.

With regard to certain aspects (issues) of the harmonization of the financial and tax systems of the BRICS, it is possible to draw the following additional conclusions. A comparative legal analysis of the legislation of BRICS shows that one of the key problems in this issue is to determine the relationship between the scope of the General Anti-Avoidance Rule (GAAR) and special anti-avoidance rules (for example, the rules of insufficient capitalization, the rules of “beneficial owner,” etc.). At the same time, taking into account the differences in the legal systems of BRICS, as well as the origin of the legal systems related to the implementation of elements of the Anglo-Saxon or continental systems of law, the issue of legislative (statutory) consolidation of a common anti-avoidance rule is resolved differently in these countries: it may be present in the form of a rule of law, or its functions may be performed in certain periods by judicial practice/judicial doctrines (Nair, 2020).

The Russian Federation is a very illustrative example of such a multi-variant approach to solving the problem of tax evasion. In Brazil, the general anti-avoidance rule was introduced by law in 2001. In China, both the legislative anti-avoidance rule and administrative practice are applied. In India, the transition to legislative regulation of the issues of combating tax evasion is not fully completed. And in South Africa, despite the fact that there is a general anti-avoidance rule, judicial doctrines dominate the legislative regulation. In the context of the above, the issue of developing a consolidated or at least agreed position of the BRICS countries on understanding the scope (and acceptable limits) of the general anti-avoidance norm becomes important.

This issue will not necessarily require harmonization or the development of an international agreement since in this case, the solution of this issue depends primarily on the unity and fundamental consistency of the BRICS tax policy.

The Russian Federation is also a good example of regulating this issue, despite the fact that legislation on controlled foreign companies was introduced quite recently and is based on the experience of OECD countries (including the United States, France, and

Germany). In general, as follows from the Declaration of the BRICS Summits, BRICS do not deny the need to use these tools as an acceptable form of combating aggressive tax planning. However, the issue of mutually limiting the possibility of applying the legislation on controlled foreign companies in the BRICS countries to economic agents (companies) that have a residence deserves consideration. Since BRICS are usually not among the jurisdictions that misuse low taxation for the purpose of harmful tax competition, this form of mutual trust in the implementation of their tax policies can be acceptable. Many initiatives to develop an institute for international exchange of tax information came from the OECD and were developed in detail within this organization. None of the BRICS countries participates in this organization (only Brazil has significantly approached full membership in the OECD in recent years), but the G20 initiative has become a new format for implementing these developments.

The necessary infrastructure for implementing all forms of tax information exchange in the BRICS countries is either ready or in the final stage of preparation, but neither experts nor tax administrations exclude the occurrence of legal difficulties, including disputes between tax administrations and taxpayers (owners of information). In addition to the introduction of common approaches to the exchange of tax information, predetermined by standards and forms developed in international declarations and communiqués, deepening of cooperation between the tax authorities could be the first stage in the development of advanced institutions (forms) for the exchange of tax information. This includes a spontaneous exchange of tax information and transfer of tax information to a third party. This form, provided for by agreements already concluded between the BRICS countries, is the transfer of tax information by the tax authority of one state to the tax authority of another state on its own initiative, based on its own understanding that such information can be used for tax control and prevention of tax evasion by the state to which the information is transferred. This form of exchange of tax information is quite sophisticated and requires good training, a high level of interaction between the tax services of the BRICS countries, and an understanding of each other's national tax systems and legislation. In addition to the spontaneous exchange of tax information, "transfer of tax information to a third party" can be used. According to the current principles laid down in international agreements based on current standards, the transfer of tax information to a third party requires the consent of the state from which the information was originally obtained.

The beginning of development of this direction could be the inclusion of a corresponding condition in the existing agreements between the BRICS countries, with a possible subsequent inclusion of similar conditions with other states (if the experience turns out to be positive). A successful development of cooperation between the competent authorities of the BRICS countries in these areas will also make it possible to conduct parallel and joint tax audits (tax investigations). As for the starting point for this direction of cooperation development, a Fund has already been created in the form of regular meetings of heads of tax administrations and regular mutual consultations (Lissovolik & Vinokurov, 2019). Regarding a possibility of creating alternative channels for the exchange of tax information, no separate work is being done in this direction, as far as is known from publicly available

sources. At the same time, if there are any insuperable obstacles to the exchange of tax information based on existing and implemented standards and concluded international agreements, the BRICS countries may be able to quickly organize alternative channels and standards based on the already established links between the tax administrations of the countries. To highlight the problems of harmonization on these issues, at this stage of the study, a comparative legal analysis of the national legislation in Russia and Brazil was carried out as having fundamental similarities in the characteristics of their legal systems. It should be noted that the national tax legislation of Russia and Brazil does not contain a detailed definition (of a legal nature) in relation to the concept of reclassification of income and operations, but there are prerequisites for developing a unified approach to this issue in the context of interaction in the BRICS format. At the same time, constitutional and legal differences in the national tax systems of the Russian and Brazilian states are not a significant obstacle to developing common approaches to combating tax evasion. Both in Russia and in Brazil, a legal regulation of relations on the re-qualification of facts for the purpose of countering tax evasion has a clear constitutional and legal basis. The exercise of universal freedoms in any economic activity should not be based on a legal qualification of facts by taxpayers in order to infringe on the right of states to collect taxes in accordance with the procedure established by law.

For example, Brazil's special rules on under-capitalization do not entail any other tax consequences, except restrictions on interest deduction, which distinguishes them from the Russian national rules governing similar relationships (Gorbunova et al., 2020).

When differentiating re-qualification from changes in interpretation, ignoring a taxpayer's legal qualification (countering abuse of law) should be taken into account:

- application of a rule of law that, in the opinion of the state represented by the tax authorities, is not applicable to the situations under consideration (incorrect legal qualification) — a change in legal qualification should be applied (re-qualification)
- incorrect interpretation of the existing tax legislation — a change in interpretation should be applied
- application of a rule of law in a way that is considered unacceptable for a bona fide participant in tax relations (abuse of a taxpayer's rights) — ignoring the legal qualification proposed by the taxpayer should be applied.

Although the Brazilian tax legislation does not contain the concept and clear rules for the re-qualification of income and operations, the legal basis for such re-qualification is already laid down both at the constitutional level and at the level of tax legislation (Article 116 of the National Tax Code).

Taking into account the analysis of law enforcement practice, we can conclude that due to the lack of development of the conceptual and legal apparatus of retraining in Russia and Brazil, there is a strong need for:

- re-qualification of the category (type) of the object of taxation (change in the legal qualification of income, profit, capital, property (or its individual characteristics), operations, etc.)
- re-qualification of the transaction and/or activity generating the object of taxation (change in the legal qualification of transactions, characteristics and essence of the activity leading to the formation of the object of taxation)

- re-qualification of the status of a subject of tax relations in order to be recognized as a taxpayer (change in the legal qualification of the tax-legal status, civil status).

Special re-qualifications are made on the basis of national and international legal regulations. It is proposed to consider certain types of general qualifications as special qualifications.

Re-qualification of the category (type) of the object of taxation should include:

- re-qualification of interest in dividends under the rules of insufficient capitalization
- re-qualification of the price, as well as other terms of transactions based on the “arm's length” principle and transfer pricing rules.

Re-qualification of an operation and/or activity that generates a taxable object should include cases when the legal qualification of a transaction changes, in which one type of legal relationship is replaced by another and this affects the size of the tax base.

Re-qualification of the status of a subject of tax relations should include cases with recognition (non-recognition) of a permanent establishment, recognition (non-recognition) as a controlled foreign company, resident, application of the rules on the beneficial owner and limitation of benefits under the contract.

Reclassification of an income-generating operation under debt relations unreasonably entails more serious legal consequences for a taxpayer than in the case of income reclassification, and therefore it seems unreasonable to apply to debt relations the reclassification of income and operations on the basis of a general norm if a special one is not applied on formal grounds.

A comparative analysis can serve as a basis for harmonizing law enforcement practices in this sensitive area of business (initially, in the jurisdictions of Russia and Brazil) which in the future will provide a greater degree of transparency of the business environment within BRICS (and, to some extent, in the global dimension, given the role of these states as the regional economic leaders in Northern Eurasia and Latin America, respectively) (Yadav, 2018). The issue of a person's tax residence is entirely regulated by national law, and double taxation agreements are applied when situations of double (multiple) residence arise. Consequently, introduction of any universal regulatory rules in this area is the most difficult task. The analysis does not exclude that BRICS approach can be a common understanding of the tax residency of companies and expressing it in the form of soft law acts and recommendations addressed to national legislators and law enforcement agencies.

Moreover, in relation to companies, there are promising measures to ensure the unity of approaches to this issue, including based on the positions of the BRICS countries: for example, the criterion of incorporation (registration) in the general sense is laid down in the rules of tax residence of companies in India, China, Russia and South Africa. Despite the apparent formality of the issue under consideration, the rules for confirming the tax residence of a source of income are crucial in order to give a taxpayer a real opportunity to apply the relevant international tax agreement. At the same time, these rules are completely outside the scope of double taxation agreements — bilateral and concluded in a multilateral format. The lack of an agreed position of the BRICS countries can significantly complicate mutual investment, especially for small and medium-sized businesses, which representatives have difficulties obtaining a tax resident certificate, which may become a barrier to the implementation of an economic project. In this regard, the

conducted comparative legal analysis gives grounds to suggest that the BRICS countries should harmonize their formal requirements for tax residency certificates, as well as for documenting tax payment in a foreign jurisdiction since, in our opinion, there are no objective obstacles to BRICS having a common approach to regulating these issues (Salm, 2017).

The result of the harmonization can be reflected in signing of a BRICS multilateral agreement on the approval of a single universal form of the certificate of tax residence of a BRICS company. The same approach can be applied to harmonizing the regulation of requirements for confirming the fact of payment of tax in any of the BRICS jurisdictions (in the source of income). At the same time, the BRICS countries position themselves as developing economies, and this can become a link in establishing a coordinated tax policy since, as noted earlier, the tax system and tax policy of a state determine its investment attractiveness. However, such coordination should not violate the legal sovereignty of states, but should promote the desire for a uniform interpretation of international legal tax rules, which will allow taxpayers (foreign investors) to be in an equal legal position on the territory of the BRICS countries.

Also, the analysis does not reveal sufficient unity of approaches in defining the concept of permanent representation in BRICS. At the same time, the BRICS countries can agree on positions on certain types of permanent missions and further express them in national legislation and bilateral agreements. In particular, in the field of rules on permanent representation arising from the provision of services permanently in the territory of the place of income, the relevant provision of the latest version of Article 5 of the UN Model Convention can be used as the basis for developing a general model of legal regulation. In all BRICS countries, mediation procedures are regulated by law and are mainly used in private law disputes.

In the Russian Federation, mediation is also widely used in resolving civil, arbitration, labor, and family conflicts. However, in terms of tax disputes, Russian legislation does not formalize relevant mediation procedures, although certain elements of mediation take place in the practice of resolving tax disputes. At the same time, development of alternative conciliation procedures is envisaged as one of the strategic guidelines in the field of pre-trial settlement of tax disputes and one of the main directions of the tax policy of the Russian Federation.

In other BRICS countries, mediation has also been introduced into the system of tax disputes, as evidenced by the institutions of CARF (Brazil), tax commissioners or tax ombudsmen (India, South Africa), and professional tax consultants (China, South Africa) (Vinnitskiy, 2018). Moreover, in some BRICS countries, tax mediation has already become widely implemented, despite the absence of legally established rules for conducting mediation procedures in tax disputes (Brazil, South Africa).

Conclusion

The mutual exchange of experience in using mediation within BRICS and the development of uniform approaches to this institution in the field of taxation look promising. In addition,

all tax agreements concluded and in force between the BRICS countries provide for the possibility of initiating mutually agreed procedures on disputed tax issues, the potential of which can be revealed in specific mediation forms of tax dispute settlement developed in BRICS. In many BRICS countries, there is a common approach to regulating the pre-trial procedure for resolving tax disputes and searching for alternative (mediation) ways to resolve them — institutions of tax consultants and tax ombudsmen (commissioners), systems of administrative tax courts, etc. — which provides conditions for the convergence of law and mediation practices of the BRICS countries in the field of tax mediation, establishing and developing friendly relations between the communities of these states. Synthesis of the best mediation practices of the BRICS countries is also effective, because their tax authorities have a comparable level of development (in the area under consideration). Thus, there are necessary prerequisites for the institutionalization of tax and financial mediation in the BRICS countries.

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