1. The evolution of EU-China trade partnership and tax-related issues

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1.1. Introduction

The People's Republic of China ("China") nowadays is a strategic partner of the European Union ("EU"), as well as a strategic rival, proposing alternative models of governance in certain fields and being a leading technological power.

The EU-China trade relationship started officially in 1975. Since then, the soaring globalised economy and the intensification of digitalization broadened the connections between the two parties, and so the interactions of the tax systems who lead to an increase of the risk of tax-related barriers and distortions on the one hand, and on the other hand the exploitation of mismatches between different tax regimes by businesses operating internationally. International trade and taxation are strictly related.

Even if sometimes it is alleged the lack of transparency and of level playing field on the Chinese side, it is undeniable that the EU and China are still open to cooperation and that the EU is showing its intention to found a balance in trade and tax matters, insisting on reciprocity, to minimize the mentioned risks.

1.2. Evolution of relationships from the 1978 Trade Agreement to the CAI and the BEPS Action Plan: bridging the links

Ten years after the creation of the EU Customs Union, a first agreement marked the beginning of trade relationships between the EU and China, despite the different nature of the interests of the two contracting parties underlying the signature –primarily economic for the first and political for the second[2]. On 3rd April 1978, the official signing ceremony took place in Brussels – it was the first occasion on which the institutions of the European Economic Community ("EEC") received a member of the Chinese government[3]– and on 1st June 1978 the *Trade Agreement between the European Economic Community and the People's Republic of China* entered into force[4] ("1978 Trade Agreement").

As far as tariffs are concerned, the two parties agreed to apply the most-favoured-nation ("MFN") clause[5]. So, any favourable provisions as regards customs duties and any taxes and charges in connection with importation and exportation of goods and services under other treaties with other contracting parties shall be accorded in the exchanges between the nine EEC countries[6] and China – exception made for customs unions, free trade areas, advantages to neighbouring countries and obligations undertaken under international commodity agreements. One of the main clauses of the General Agreement on Tariffs

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2 ECC was interested in signing a trade agreement with China for "economic gains", while the reasons encouraging China to these negotiations were mainly political, see XIAOTONG, Z. "Linkage Power. How the EU and China managed their economic and trade relationship", in TELÓ, M., CHUN, D. and XIAOTONG, Z. (2018) (eds.), *Deepening the EU-China Partnership. Bridging Institutional and Ideational Differences in an Unstable World*, Routledge, Oxon and New York, 2018, p. 155-156.

3 See European Communities – The Council, *Signing of the trade agreement between the EEC and the People's Republic of China. Speech by K.B. Andersen, President in Office of the Council, Minister for Foreign Affairs of the Kingdom of Denmark*, Brussels, 3 April 1978.

4 COUNCIL REGULATION (EEC) No 946/78 of 2 May 1978 concerning the conclusion of the Trade Agreement between the European Economic Community and the People's Republic of China.

5 Art. 2 of the 1978 Trade Agreement.

6 Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, Netherlands and United Kingdom.

and Trade ("GATT")[7] were therefore included in this first agreement, even if China was not yet a member of the GATT/WTO (*see below*).

Moreover, China undertook to consider Community imports in a favourable light and the ECC of nine, for its part, committed itself to endeavour to increasingly liberalize imports of Chinese origin, extending the list of liberalized products and augment the amounts of quotas[8]. To boost the cooperation, they also agreed to create a Joint Committee.

Considering the satisfactory application of the 1978 Trade Agreement[9], the EEC and China decided to enter into a new trade agreement –the *Agreement on Trade and Economic Cooperation between the European Economic Community and the People's Republic of China* ("1985 Trade Agreement")– which was signed on 21st May 1985 and entered into force on 1st October 1985. As regards tariffs, the terms of the 1985 Trade Agreement were the same as those of the 1978 Trade Agreement: the MFN was reiterated. As it is evoked by the official title, the novelty aspect with respect to the previous treaty relates to the new provisions about the *economic cooperation*, including the promotion of investments and the enhancement of a propitious framework for the latter[10]. In any case, the EEC Members States were still allowed to undertake bilateral activities and conclude agreements relating to economic cooperation[11].

The mentioned two agreement are a manifestation of the trend reversal of the Beijing glance towards the outside world, opening the doors to foreign investment[12].

This change is also perceived in the purely (international) fiscal sector. It is during the Eighties that the first double tax treaties, including those with some of the EEC countries[13], were negotiated and signed. Moreover, starting from the 1979, several acts concerning the taxation of foreign investments were enacted to attract the latter and expand economic cooperation: on 1 July 1979 the Act of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment, on 10 September 1980 the Income Tax Act of the People's Republic of China Concerning Joint Ventures with Chinese and Foreign Investment, on 13 December 1981 the Income Tax Act of the People's Republic of China for Foreign Enterprises (the two latter then replaced in 1991 by the Income Tax Act of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises)[14].

In the period at hand, the financial flow was mainly unidirectional: from the EEC companies to China and it is also confirmed by article 13 of the 1985 Trade Agreement which drawn attention on the different levels of development of the two contracting parties[15]. However, this was about to change.

China was determined to pursue the path undertaken as increasingly market-driven economy and therefore to participate in the multilateral trading system. In 1986, China requested the resumption[16] of its status as a GATT contracting party. An early accession of China to the GATT was supported by the

7 Art. 1 of the GATT.

8 Art. 4 of the 1978 Trade Agreement.

9 Preamble of the Agreement on Trade and Economic Cooperation between the European Economic Community and the People's Republic of China.

10 Art. 12 of the 1985 Trade Agreement.

11 Art. 14 of the 1985 Trade Agreement.

12 AUYEUNG, P. K. (2003). "Taxation Trends and Issues in the People's Republic of China: 1984 to 2006", in *Bulletin for International Taxation*, IBFD, Amsterdam, June 2008, p. 249.

13 *E.g.* with France in 1984, Italy in 1986, Netherlands in 1987, United Kingdom in 1984. See www.oecd.org.

14 WTO, *Accession of the People's Republic of China. Decision of 10 November 2001*, 23 November 2001, WT/L/432, pp. 75-76, available at www.wto.org; AUYEUNG, P. K. (2003).; *op. cit.*, pp. 249-251; BAO, L. "China's Tax Policy toward Enterprises with Foreign Investment: A Comprehensive Appraisal", in *Intertax*, Kluwer Law International, 2003, Vol. 31, Issue 2, pp. 66 *et seq.*

15 "In view of the difference in the two Contracting Parties' levels of development, the European Economic Community is prepared, within the context of its development aid activities, within the means at its disposal, and in accordance with its rules, to continue its development activities in the People's Republic of China. / It confirms its willingness to examine the possibility of stepping up and diversifying these activities."

16 China was a signatory of the GATT in 1948, but –after the revolution in 1949– the Taiwan government announced the withdrawal from the GATT. The Beijing government never acknowledged the latter withdrawal; however, it notified the resume of the membership in 1986. See WTO Press Release, "WTO successfully concludes negotiations on China's entry", 17 September 2001, Press/243, available at www.wto.org.

EEC with which Beijing carried out bilateral negotiations[17]; but due to historical, economic and political reasons it was delayed until 2001, when China acceded to the Marrakech Agreement Establishing the World Trade Organization ("WTO Agreement") and thereby became a member of the World Trade Organization ("WTO"). One of the interests of the EEC, then –since 1993– the European Community ("EC"), was to improve "the climate for European investment in China"[18] and so also to significantly whittle Chinese import tariffs on industrial and agricultural goods as well as to ameliorate the establishment and trade conditions in China for foreign companies[19]. This goal was attained quite successfully. From a tax perspective, a series of important commitments were undertaken by China, *inter alia*[20]:

1. The foreign individuals and enterprises will be accorded treatment no less favourable than that accorded to those in China (even as regards border tax adjustments);
2. The elimination of subsidy programs falling within the scope of article 3 of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement");
3. China will ensure the compliance of customs fees, internal taxes and charges with the GATT;
4. The elimination of all taxes and charges on exports, except for those specifically provided in the Protocol or applied in conformity with Article 6 of the GATT;
5. The notification of subsidies pursuant to Article 25 of the SCM Agreement;
6. China bound tariffs for imported goods, it committed to decrease the average bound tariff level for agricultural and industrial products and it will eliminate several tariffs and reduce others mostly by 2004 and in any case no later than 2010.

Simultaneously, in 1997 the EC Council authorised the EC Commission to negotiate a customs cooperation agreement on behalf of the EC and in 2004 it approved the *Agreement between the European Community and the Government of the People's Republic of China on cooperation and mutual administrative assistance in customs matters* ("CCMAA"). Taking also into account that "operations in breach of customs legislation including infringements of intellectual property rights are prejudicial to the economic, fiscal and commercial interests of both Contracting Parties"[21], China and the EC decided to enhance the cooperation between competent administrative authorities in ensuring the accurate assessment of customs duties and other taxes. Customs cooperation covers all matters relating to the application of customs legislation[22], including exchange of information and expertise on customs techniques and procedures, exchange of personnel and training, seeking a coordinate position in the context of international organisations as well as the assistance in ensuring the proper application of customs duties (*i.e.* recovery of duties, taxes or fines, arrest or detention) and prevention and fight against fraud[23]. Recently, to reiterate and increase the effectiveness of the mutual cooperation and assistance in the field of customs, the European Commissioner for Economic and Financial Affairs and the Minister of Customs of China has signed a *Strategic Framework for Customs Cooperation for the years 2018-2020*, which *inter alia* extends the collaboration to the e-commerce sector and supports the review of the CCMAA[24].

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17 Commission of the EC, *Communication from the Commission. Building a Comprehensive Partnership with China*, 25 March 1998, COM(1998)181, p. 12.

18 *Ibidem.*

19 *Ib.*, pp. 12-16.

20 Protocol on the accession of China annexed to WTO, *Accession of the People's Republic of China. Decision of 10 November 2001, op. cit.*; WTO Press Release, "WTO successfully concludes negotiations on China's entry", *op. cit.*

21 COUNCIL DECISION of 16 November 2004 on the conclusion of an Agreement between the European Community and the Government of the People's Republic of China on cooperation and mutual administrative assistance in customs matters, 2004/889/EC.

22 Art. 6 CCMAA.

23 Art. 6-10 CCMAA.

24 The mentioned Framework follows the *Strategic Framework for Cooperation* for the period 2010-2012 and that for the period 2014-2017. See the note to delegation of the Council of the European Union, *Enhancing EU-China Trade Security and Facilitation: Strategic Framework for Customs Cooperation 2018-2020 between the European Union and the Government of the People's Republic of China*, 22 May 2017, 9548/17.

Subsequently, in 2006, discussions about the update of the 1985 Trade Agreement started. Unfortunately, they have been stalled since 2011, but the negotiations evolved and lead to a China's proposal of a free trade agreement ("FTA") and later, in 2012[25], to the launch of talks about a EU-China Comprehensive Agreement on Investment ("CAI") on the basis of the EU's objective to replace all the bilateral investment treaties ("BITs") concluded by the EU Member States with China[26]. In 2016 the parties established a joint negotiating text and the negotiations rounds about the CAI are still and frequently on the Brussels and Beijing agenda in order to conclude the agreement by 2020[27]. From a EU point of view, a unitary and reassuring legal framework is needed: the comprehensive agreement that EU Commission Directorate-General for Trade and the European External Action Service ("EEAS") are bargaining is a good legal instrument.

The CAI scope goes beyond the usual dimension of investment protection and additionally cover market access that goes also through taxation. There is a proposal of a tax provision to be included in the CAI, but the EU Commission Directorate-General for Taxation and Customs Union has not been still effectively involved, since direct taxation is part of the general exemptions – one of the last provisions of the agreement. Nevertheless, there are tax-related aspects – even sensitive – that have already been debated, but that are still controversial, such as the case of disinvestments and tax measures that may amount to expropriation of investors' assets (*see* para. 1.3)[28].

In the light of the above, we can affirm that the register and the matters mooted have evolved, inasmuch China is not the same developing country with which the EU signed the 1985 Trade Agreement.

Another evidence of this change is the Beijing active participation in the international forum to tackle the *BEPS* issues to protect its tax base. China is a *key partner* –not a member– of the Organisation for Economic Co-operation and Development ("OECD"), it is a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes and it is committed to implement the G20/OECD Base Erosion and Profit Shifting ("BEPS") Action Plan released in 2015[29], working closely with the EU Commission which takes part in the work of the OECD, together with the majority of the EU Members States that are also OECD members[30]. This is one of the direction of changes driven by the Belt Road Initiative ("BRI") – weather at treaty level that at domestic level –, combined with the progressive removal of tax barriers to facilitate Chinese outbound investments, including the strengthening of collaboration between the China State Administration of Taxation with the local officers of other countries.

1.3. Distinctive challenges

The (trade) relationship between Europe and China is long-established and nowadays it is acknowledged the important role of China in international tax law making. Connections rises, they are increasingly closer, and we observe a growing need to address global challenges by global solutions.

Nevertheless, several issues – due to different approaches – come to light and it seems necessary to untangle them in order to proceed on the taken route.

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25 Council of the European Union, *Joint Press Communiqué of the 14th EU-China Summit*, 14 February 2012, 6474/12 PRESSE 50, §11, p. 2.

26 Since the entry into force of the 2009 Lisbon Treaty, the EU gained the exclusive competence for foreign direct investment. See Art. 207 TFUE.

27 The last round (the 23rd) of the negotiations for the CAI has been held in Beijing on 23-24 September 2019. See European Commission Directorate-General for Trade, *Note to the file. Report of the 23rd round of negotiations for the EU-China Investment Agreement*, 25 September 2019, available at www.trade.ec.europa.eu.

28 European Commission Directorate-General for Trade, *Note to the file. Report of the 18th round of negotiations for the EU-China Investment Agreement*, 18 July 2018, European Commission Directorate-General for Trade, *Note to the file. Report of the 19th round of negotiations for the EU-China Investment Agreement*, 13 November 2018, and European Commission Directorate-General for Trade, *Note to the file. Report of the 20th round of negotiations for the EU-China Investment Agreement*, 1 March 2019, available at www.trade.ec.europa.eu.

29 See *infra* section III.

30 Twenty two of the thirty six OECD members are also EU Members States.

At the EU level, transparency is increasingly becoming one of the operative words in the tax law sector (and even beyond) under the overarching concept of good tax governance[31], in order to tackle tax fraud, evasion and avoidance, protect the integrity of tax systems and foster fair taxation[32]. To this aim, the EU encourages positive changes through cooperation and this is always on the negotiations agenda between the EU and China, ranging from the general market model and the legal system to the economic and monetary policies as well as the food safety regime or the energy sector[33].

On the same wave, to ensure good economic relations between the EU and China, the state aid policies and the regulation of the Chinese state-owned companies are constantly under the spotlight – even tax measures can constitute state aid. Since 2001[34], the EU-China dialogue on competition policy has been intensified and, recently, a new *Memorandum of Understanding on a dialogue in the area of the State Aid Control and the Fair Competition Review* has been signed to enhance the exchange of good practices and an "effective, transparent and non-discriminatory state aid control and fair competition review"[35].

It happens that sometimes legal concepts are differently understood in distinct legal system. An example concerns taxation, disinvestment and the notion of expropriation. Investment implies the possibility of disinvestment and the latter could be usually subject to economic consequences, even tax levy. Nevertheless, if the taxation approximately amounts to the whole disinvestment it could be perceived as more than a levy and, rather, a disincentive to investment. In that case the tax measure imposed may consist in an expropriation and therefore not being compliant with the national treatment principle. In the context of the CAI, the EU and China have different positions as regards this aspect – and in particular the identification of an expropriation as a result of a tax measures and the tax dispute exclusion clause in the CAI[36]. The negotiations are still in progress.

Lastly, the attention should be drawn on a slippery area that is mainly internal to the EU but that has an impact on the relationship with third countries: the EU competence as regards (international) taxation. On the one hand, difference is made between direct and indirect taxation. With respect to direct taxation – taxes on natural persons and companies income –, it is still a competence of the Member States ("MS"), even if the principle of the primacy of the EU law over the MS domestic law applies[37] and the EU gave and is giving a framework to the national regulations[38] under article 115 of the Treaty on the Functioning

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31 As regards good tax governance, see HJI PANAYI, C. "The Europeanization of Good Tax Governance", in *Yearbook of European Law*, Oxford University Press, Oxford, Volume 36, 2017, pp. 442-495; MOSQUERA VALDERRAMA, I. J. "The EU Standard of Good Governance in Tax Matters for Third (Non-EU) Countries", *Intertax*, Issue 5, 2019, pp. 454–467.

32 Reference is made in particular to the Code of Conduct for Business Taxation (Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997 on a code of conduct for business taxation) as well as the strengthening of the administrative cooperation in the field of direct taxation and in the VAT sector (Council Directive (EU) 2011/16/EU on administrative cooperation in the field of direct taxation –also known as "DAC"– as lastly amended in 2018; Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax, lastly amended in 2018).

33 European Commission - High Representative of the Union for Foreign Affairs and Security Policy, *Joint Communication to the European Parliament and the Council. Elements for a new EU strategy on China*, 22 June 2016, JOIN(2016) 30 final, available at www.eeas.europa.eu; European Commission Directorate-General for Trade, *Note to the file. Report of the 16th round of negotiations for the EU-China Investment Agreement*, 12-15 December 2017, available at www.trade.ec.europa.eu.

34 See "Declaration on the start of a dialogue on competition by the EU and China" available at www.ec.europa.eu.

35 Memorandum of Understanding on a dialogue in the area of the State Aid Control and the Fair Competition Review between the State Administration for Market Regulation of the People's Republic of China and the Directorate-General for Competition of the European Commission, 9 April 2019, available at www.ec.europa.eu.

36 European Commission Directorate-General for Trade, *Note to the file. Report of the 16th round of negotiations for the EU-China Investment Agreement, op. cit.*; European Commission Directorate-General for Trade, *Note to the file. Report of the 19th round of negotiations for the EU-China Investment Agreement, op. cit.*; European Commission Directorate-General for Trade, *Note to the file. Report of the 20th round of negotiations for the EU-China Investment Agreement, op.cit.*

37 *Inter alia* CJCE, 13 December 1967, C- 17/67, *Neumann/Hauptzollamt Hof/Saale*; CJCE, 13 December 2005, C-446/03, *Marks & Spencer*.

38 See, for example, Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States; Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States; Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation; Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States; Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices

of the European Union ("TFEU") which sets forth the approximation of MS legislations affecting the internal market. Concerning indirect taxation, we should distinguish between customs duties – which fall within the EU exclusive competence[39] – and the excise duties and the value added tax ("VAT"), which, instead, are "only" harmonised[40] under article 113 TFUE There is no homogeneity in the decision-making processes followed for the different taxation policies. Moreover, except for customs law, both in direct and indirect taxation, it is the Council who, upon the EU Commission proposal, adopts – acting unanimously – provisions for the approximation or harmonisation – the EU Parliament having a consultative role only. Also due to the unanimity clause, the EU has still limited powers in foreign tax policies, but if it is willing to strengthen the competitiveness of its tax system and to adapt quickly to changing economic realities, it should call for a more united voice. That is also the idea of the EU Commission, which is supporting the replacement of the unanimity principle with a qualified majority voting since "EU tax policy must be able to react and adapt quickly" and "a coordinated EU action in taxation is essential to protect Member States' revenues and ensure a fair tax environment for all"[41].

1.4. Conclusions

Global challenges require international cooperation, and the tax sector is also concerned. The partnership between the EU and China has become progressively closer in a wider range of fields. The EU has always supported a greater integration in multilateral initiatives of global interest and both parties still promote a coordinated approach even towards exchanges of experiences to deal with tax matters this changing world is experiencing, for the benefit of all. The importance of cooperation in tax matters has been emphasised from both parties and a bilateral regulation between the EU and China could be an effective solution. The dialogue is consolidated, frequent and based on trust and respect, even if on some thorny topics the positions differ and they are the discourse priorities. Nevertheless, the main challenge for the EU is still internal: the actualisation of the internal market should not be the sole concern when it exercises its fiscal power. A broader outlook is needed and the EU should call for full unity among the Members States in cooperating with China to reach its full potential.

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that directly affect the functioning of the internal market; Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), 25 October 2016, COM(2016) 683 final; Proposal for a Council Directive on a Common Corporate Tax Base, 25 October 2016, COM(2016) 685 final.

39 The EU is a Customs Union which is governed by the Union Customs Code (Regulation (EU) No 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code).

40 The directives allow a relatively little leeway in their transposition (albeit significant, as regards VAT, in terms of rates and exemptions). See Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax; Council Directive 2008/118/EC of 16 December 2008 concerning the general arrangements for excise duty; Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax.

41 Communication from the Commission to the European Parliament, the European Council and the Council - Towards a more efficient and democratic decision making in EU tax policy, 15 January 2019, COM(2019) 8 final, p. 1.