WHU

Global Minimum Tax Reform and China

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I. Background and main rules of Global Minimum Tax Reform

- “race to the Bottom”
- 15 BEPS Action Plans (2015)
- Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (2021)
- Global Anti-Base Erosion Model Rules (Pillar Two) (2021)

I. Background and main rules of Global Minimum Tax Reform

- GLoBE rules
  - MNE Groups(annual consolidated revenues equal or exceed EUR 750 million)
  - IIR
  - UTPR
  - Top-down approach
  - Optional or mandatory?
- Qualified Domestic Minimum Top-up Tax (QDMTT)

I. Background and main rules of Global Minimum Tax Reform

- STTR
  - Developing countries
  - 9%
  - The order of application

I. Background and main rules of Global Minimum Tax Reform

- China’s Stance
  - Liu Kun, Chinese Finance Minister
  - Meng Yuying, Director General of the Department of International Taxation of the State Administration of Taxation
- Current Situation in China
  - New development paradigm featuring “dual circulation”

II. Impact of Global Minimum Tax Reform on China and Its Response

1.GLoBE rules will challenge the tax sparing credit provisions in China's bilateral tax treaties.

Types of tax sparing credit	The other contracting party （countries/regions)	Number
Unilateral tax sparing credit	Japan， Singapore， Canada， Australia， The United Arab Emirates， Luxembourg	6
Bilateral tax sparing credit	Malaysia， Thailand， Italy， Bulgaria， Pakistan， Cyprus， Korea， Papua New Guinea， Mauritius， Vietnam， Jamaica， Bosnia， Serbia and Montenegro， Magiton， Portugal, Seychelles， Cuba， Oman， Tunisia， Sri Lanka， Trinidad and Tobago， Morocco， Kuwait， Brunei， Saudi Arabia， Nepal， Ethiopia， Cambodia。	29

II. Impact of Global Minimum Tax Reform on China and Its Response

- Tax laws in Vietnam :
  - The income tax rate of enterprises investing in some specific projects in coastal and port economic zones is 10%, with a preferential period of 15 years, tax exemption for the first four years and halving for the next nine years.
  - Starting from 2016, the corporate income tax rate falls to 20%.

II. Impact of Global Minimum Tax Reform on China and Its Response

- Changes in tax burden of Chinese enterprises investing in Vietnam before and after the implementation of IIR in China (enterprises investing in projects in coastal and port economic zones)

	No IIR implementation in China	IIR implementation in China
tax on Vietnamise income (expressed as a percentage, hereinafter)	0、5%、10%	0、5%、10%
back taxes to China	5%	15%、10%、5%
Total tax burden	5%、10%、15%	15%

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- Solution: the tax deemed to have been paid according to the tax sparing credit provisions should also be treated as the covered tax in the ETR calculation.
  - Effective tax rate = Covered taxes / GLoBE tax base

II. Impact of Global Minimum Tax Reform on China and Its Response

2. Inconsistency between the GLoBE rules and China's participation exemption rules.

- Dividend Exclusion rule under the GloBE rules
- A Constituent Entity's Financial Accounting Net Income or Loss is adjusted for the following items to arrive at that Entity's GloBE Income or Loss： …(b) excluded dividend…
- Excluded Dividends means dividends or other distributions received or accrued in respect of an Ownership Interest, except for: (a) a Short-term Portfolio Shareholding, and (b) an Ownership Interest in an Investment Entity that is subject to an election under Article 7.6.
- A Short-term Portfolio Shareholding shall meet the following two conditions: (a) holding more than 10% of the shares; (b) A consecutive holding period of more than 1 year or 12 months.

II. Impact of Global Minimum Tax Reform on China and Its Response

- Participation exemption rules in China

Region	Content
Hainan Free Trade Port and Hengqin Cooperation Zone	Dividends from subsidiaries established with new investments in the tourism, modern service, and high-tech industry sectors will be exempted from corporate income tax if the following conditions are met: (1) the shareholder holds more than 20% of the shares of the foreign subsidiary; and (2) the statutory corporate income tax rate of the investment destination jurisdiction is not less than 5%.

II. Impact of Global Minimum Tax Reform on China and Its Response

	Participation exemption rules in China	Dividend Exclusion rule under the GloBE rules
Subject	Tourism, modern service, and high-tech industries	Constituent entities of large multinational enterprises
Minimum shareholding ratio	20%	10%
A consecutive holding period of shares	—	1 year or 12 months
Tax burden of the investment destination jurisdictions	The statutory income tax rate of enterprises in the investment destination jurisdictions shall not be less than 5%	— (If GloBE rules is implemented globally, the tax burden of the investment destination jurisdictions shall be at least 15%)

II. Impact of Global Minimum Tax Reform on China and Its Response

- Solutions
  - Expand the scope of participation exemption:
    - Increase the types of subjects;
    - Reduce the minimum shareholding ratio to 10%;
    - Set a 15% threshold for the corporate income tax rate of investment destination jurisdictions;
    - Require “consecutive shareholding period of not less than 12 months”.

II. Impact of Global Minimum Tax Reform on China and Its Response

- 3. Inconsistency between the GLoBE rules and China's CFC rules.
- Distribution tax regime under GloBE rules
  - Covered Taxes allocated to a Constituent Entity in respect of Passive Income are included in such Constituent Entity's Adjusted Covered Taxes in an amount equal to the lesser of: (a) the Covered Taxes allocated in respect of such Passive Income; or (b) the Top-up Tax Percentage for the Constituent Entity's jurisdiction, determined without regard to the Covered Taxes incurred with respect to such Passive Income by the Constituent Entity-owner, multiplied by the amount of the Constituent Entity's Passive Income includible under any Controlled Foreign Company Tax Regime or fiscal transparency rule.

II. Impact of Global Minimum Tax Reform on China and Its Response

- GLoBE rules will pose a challenge to Chinese CFC rules
  - Chinese CFC rules does not distinguish the type of CFC income, and levy tax on the all income, which will directly increase the cost of collection and administration of tax authorities, reduce its efficiency and may bring about risks in enforcement.
  - China usually applies the statutory corporate income tax rate of 25% on the CFC deemed distributed dividends, which will result in CFC tax not being fully allocated to the jurisdiction where the CFC is located.

II. Impact of Global Minimum Tax Reform on China and Its Response

	Chinese CFC Rules	IIR
Taxpayers	Resident enterprises	Chinese Constituent entities of large MNEs
Tax base	CFC deemed distributed dividends	GloBE income minus substance-based income
Applicable tax rate	25%	15%
Aggregation method	entity blending	jurisdiction blending
Exclusion rules	(1) CFC has reasonable needs for business operation; (2)CFC's incomes are mainly derived from its active business activities; (3) CFC's total annual profits are less than 5 million; or (4) CFC is a resident of a country (or region) specified by the SAT or with an actual tax rate of not less than 12.5%.	(1) Governmental Entities, International Organizations, Non-profit Organizations, Pension Funds, Investment Funds and their tools; (2) International Shipping Income ; (3) Multinational enterprise groups with annual revenues of less than €750 million; (4) MNEs with annual revenues of less than €10 million and with profits of less than €1 million; (5) the jurisdictions where Constituent entities' effective tax rate is no less than 15%.

II. Impact of Global Minimum Tax Reform on China and Its Response

- Taxpaying Exclusion rules:

	China's CFC Rules	IIR	Result
Exclusion standard	Actual tax rate of the investment destination jurisdiction (normally statutory tax rate in practice)	Effective tax rate	When taxpayers are eligible for one or more tax incentives, it is relatively easier for them to invoke the tax exclusion rules of China's CFC rules.
Exclusion threshold	12.5%	15%	It would also be easier for taxpayers to invoke the tax exclusion rules of China's CFC rules.

II. Impact of Global Minimum Tax Reform on China and Its Response

- Solutions — revision of Chinese CFC rules:
  - Tax only the CFC passive income;
  - Tax CFC passive income at the corporate income rate of 15%.
  - Raise the minimum effective tax rate of CFC's taxpaying exclusion provision to 15%, and draw on GloBE rules to identify the effective tax burden of the CFC-located jurisdiction.

II. Impact of Global Minimum Tax Reform on China and Its Response

- 4.GLoBE rules will pose a challenge to China's tax incentives policies

NO.	Tax incentives policies	specific items
1	the application of the 15% corporate income tax rate	Enterprises of high-tech industries
2		Enterprises of technologically advanced service industries
3		Encouraged industrial enterprises in the Western Region
4		Encouraged industrial enterprises in Hainan Free Trade Port
5		Encouraged industrial enterprises in Guangdong Hengqin, Fujian Pingtan, Shenzhen Qianhai
6	other corporate income tax incentives policies	Additional deductions for R&D expenses incurred in developing new technologies, new products and new crafts
7		Pre-tax one-off deduction for fixed assets valued below 5 million RMB
8		Reduction and waiving of enterprise income tax on a regular basis for eligible IC enterprises
9		Reduction and waiving of enterprise income tax on the income from technology transfer

II. Impact of Global Minimum Tax Reform on China and Its Response

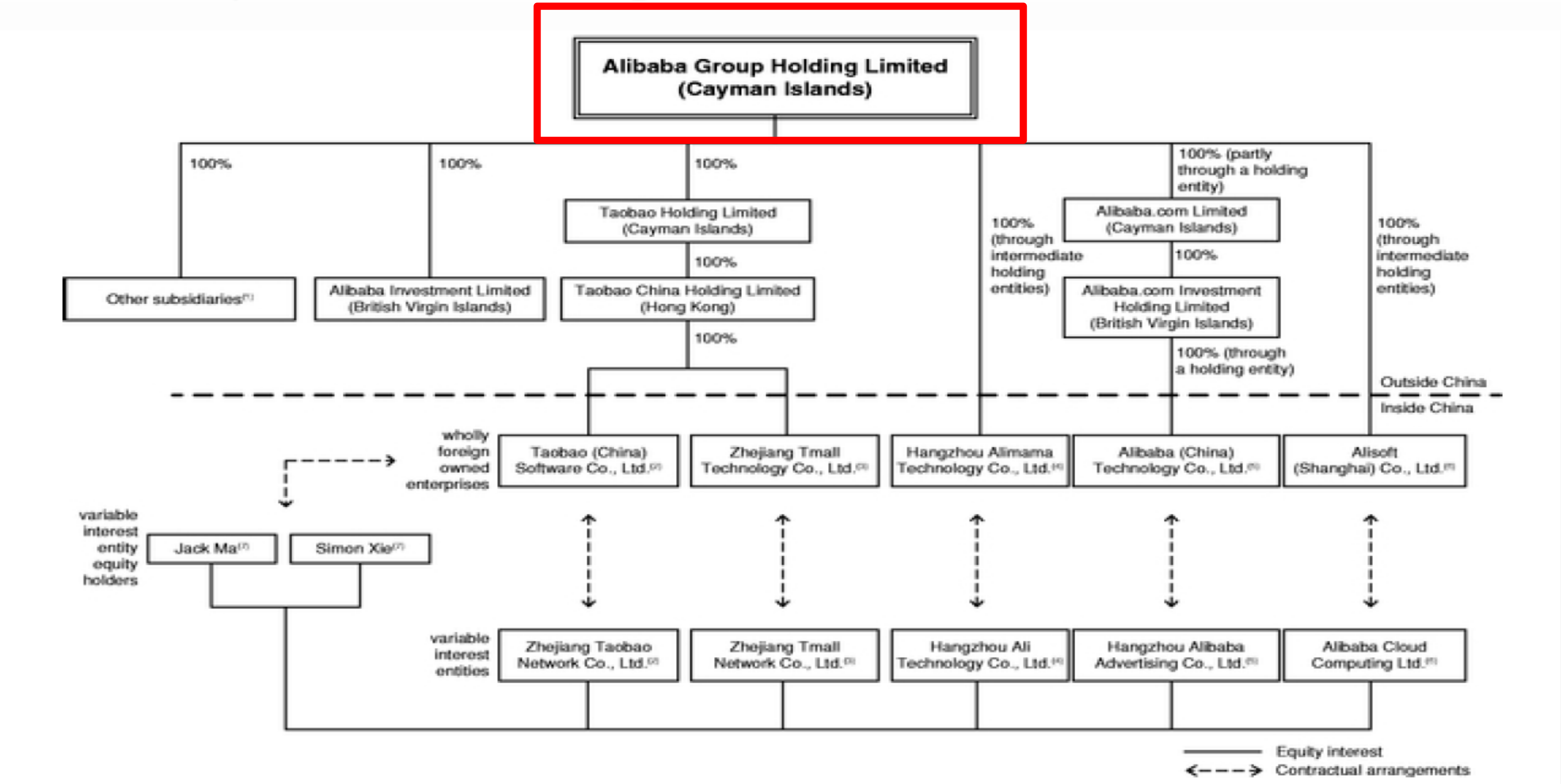
- International Responses
  - Use non-tax preferences as alternatives： Singapore
  - Choose other fiscal policies： Swiss
    - change the items of preferential tax
    - Grant financial subsidies
  - Change the way of tax incentives： UK
    - The Qualified Refundable Tax Credit （QRTC）

II. Impact of Global Minimum Tax Reform on China and Its Response

- Solutions
  - Adhere to the basic position that domestic tax should be fully imposed.
    - Simplify the current tax incentives
    - Introduce QDMTT
  - Reasonably adjust the tax policies to fully provide support to taxpayers
    - Establish a tax credit for R&D expenses

II. Impact of Global Minimum Tax Reform on China and Its Response

- 5. GloBE rules may also have an impact on the VIE structure.



II. Impact of Global Minimum Tax Reform on China and Its Response

- Issues about the determination of residene
  - The place of management or the palce of incorporation ?
- Solution: MAP / advance ruling?

Thank You!

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