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Contents

1. Introduction

In 1978, China started to pursue economic reforms and "four modernizations" under the guidance Deng Xiaoping's thinking -- "to get rich is glorious" and China should "keep a low profit and bide its time" in international relations.[1] America's "normalization with China may have been the most beneficial to world peace and understanding."[2] Since then, China has become the world's largest homogenous digital market and mobile economy,[3] the second largest capital importer and exporter, the third largest consumer market, and a critical link in the global value chains of many multinational enterprises (MNES). China recently overtook the United States (US) as European Union's biggest trading partner.

In 2021, President Xi Jinping stated: "We will work to build a new type of international relations and a human community with a shared future, promote high-quality development of the Belt and Road Initiative through joint efforts, and use China's new achievements in development to provide the world with new opportunities."[4] China announced that "the United States is not qualified to talk to China in a condescending manner."[5] President Biden regards China to be deadly earnest in trying to displace US global leadership and vowed not to let that happen under his watch.[6] The Biden administration sought to use "a tax code overhaul to reset the terms of global commerce" and "catalyzed the global tax debate by proposing a worldwide minimum tax of at least 15 percent."[7] Meanwhile, "China stands for safeguarding … the international order based on international law"[8] but would not follow "what is advocated by a small number of countries as the so-called rule-based international order."[9]

What are the implications of China's rise for the US dominance in global tax governance? Will the signs of "decoupling" or parallel standards in other areas, such as technology (e.g., 5G) and COVID-19 vaccine appear in tax policy? Will China go along with the US-catalyzed global minimum tax in Pillar Two and US-modified reallocation of residual profits to market jurisdictions under Pillar One?[10]

This article considers these questions in light of the broader historical and geopolitical context.[11] Section 2 provides an overview of the nature, purpose and legal instruments of international taxation and highlights the significance of the China versus US relationship for global tax governance. Sections 3 – 5 discuss the changing roles of China and US in the past 100 years: the US's role in creating and expanding the international tax system from 1920s to 1979; China as a norm-taker and the US as a dominant norm-setter from 1980-2007; and China and the US in the context of BEPS 1.0 (2013-2015 G20/OECD Base Erosion and Profit Shifting Project) and BEPS 2.0 (Pillar One and Pillar Two to address challenges of digitalization of the economy). Section 6 speculates about the future by teasing out the areas of convergence and divergence between two countries. The article notes in conclusion that it is unlikely that decoupling would occur in international taxation, but it remains uncertain how China's role would play out in the next steps of BEPS 2.0 and beyond.

2. From Inter-Nation Taxation to Global Taxation

2.1 Overview: International Taxation as a Sovereign and Fiscal Matter

The power to levy income taxes rests with national (and sometimes sub-national) governments. Through income tax laws, governments raise revenue to finance public expenditures (the "taxing regime") and to promote economic and social activities through tax incentives that are akin to "spending" the tax revenue that would otherwise be collected (the "tax expenditure" regime). As part of fiscal policy, tax policy is a manifestation of a country's fiscal choices, which is in turn an expression of a country's cultural, economic and social welfare conditions and choices.[12] Each country has autonomy in deciding how much revenue to collect and/or how much tax expenditure to spend. There is no overarching international law to limit such autonomy. A country can also decide not to have any income tax, which can be understood as using the entire tax system as a tax expenditure to attract capital.

In addition to the fiscal functions, corporate income tax, which is the focus of this article, also backstops progressive personal income tax to achieve distributive justice. Because corporations are the main type of economic entities in many countries and their conduct directly impact a country's economic, social and environmental conditions, corporate tax policies often seek to regulate or guide corporate behavior for societal purposes. Multinational enterprises (MNEs) can thus be viewed as "agents" of the state to this extent. How to deal with MNEs' income lies at the heart of inter-nation tax relations.

2.2 Main Issues in Inter-nation Tax Relations

Inter-nation tax issues arise when taxpayers or their transactions cross-over the boundaries of national tax systems. The main issues include: double taxation, distribution of taxing rights between countries, stateless income, and extent of constraints on national fiscal sovereignty.

Double taxation exists when two tax systems intersect. It can impede cross-border trade and investment by increasing transaction costs for MNEs, thereby reducing the economic welfare of both countries. To prevent double taxation, in addition to unilateral measures, countries rely on bilateral tax treaties to coordinate the application of their tax systems without compromising their fiscal/tax independence. Even though "models" have been prepared as early as the 19203 by the League of Nations (the "League") and used by countries, bilateral tax treaties are not uniform, reflecting the diverse national fiscal interests.[13]

On the matter of taxing rights, however, there is a broad acceptance of the so-called residence/source paradigm. Under this paradigm, with respect to MNEs, a country is either a residence country or source country and income is either income from business, income from investment (e.g., dividend, interest and royalties) or capital gains. The residence country has exclusive or residual right to tax a resident taxpayer's income derived in the source country and has the obligation to provide relief from double taxation through an exemption or foreign tax credit method. The source country's taxing right is conditional upon the existence of permanent establishment in the case of business income and is limited in the case of investment income. When cross-border flows of income are symmetrical between the two treaty partners, the paradigm works well. In other circumstances, the paradigm favors the residence country. The "revenue losing" source country can be presumed to use the treaty as a "tax expenditure" in order to create better trade and investment conditions and stimulate economic development.

Stateless income is often the result of tax planning by MNEs that is "inconsequential or non-transformative"[14] in an economic sense but "sanctioned" or "tolerated" by national tax laws. In other words, the "multinational" nature of taxpayers or income is not matched by any "multinational" tax system. Therefore, addressing the stateless income issue requires multilateral efforts, such as BEPS 1.0.

Bilateral tax treaties generally do not encroach upon domestic tax expenditure programs beyond requiring non-discrimination treatment of taxpayers resident in the other country. Recent multilateral efforts to address the stateless income issue, by nature, must intersect with the use of tax expenditures, in the form specific tax preferences or the corporate tax system as a whole (i.e., a tax haven). The shift from inter-nation tax relations to multilateral relations cannot be divorced from national fiscal choices and their underlying economic and other strategic national objectives.

2.3 Shift from Inter-national to Global Tax Governance

Evidence of recent shift towards global tax governance can be found in the 1998 OECD report on *Harmful Tax Competition: An Emerging Global Issue,*[15] multilateral efforts in administrative assistance,[16] exchange of information and common reporting standard,[17] and the multilateral instrument (MLI) to implement anti-treaty abuse measures in BEPS 1.0;[18] and BEPS 2.0.

Directionally speaking, the shift is moving from collaboration in the administration and protection of existing tax rights towards agreement on sharing new taxing rights over residual profit (e.g. under Pillar One) and curtailing national fiscal choices that are perceived to be harmful to other countries' interests (e.g., Pillar Two). It is a paradigm shift that would be difficult in the absence of collaboration between hegemonic powers. In the 1920s, the US and Great Britain could be credited for creating the existing inter-nation tax system. In the 2020s, will China join the US in creating a global tax system?

2.4 China and US as Great Powers?

The US has played a pivotal role in shaping international tax norms[19] to advance its interests. China has adopted international tax norms to serve its interests in achieving economic transformation and becoming a global power (see section 4). Perhaps not quite an "equal" in terms of using technical and legal skills to advance tax policy objectives, China is arguably closer to the US than any other country in terms of global influence.

China and the US share some common interests in tax policy that are dictated by the economic reality of being the world's largest capital importing and exporting countries. Both use tax policy to advance strategic interests. However, on the issue of which country is the tax home of residual or stateless income, which is the heart of the two pillars, the two countries seem to have different ideas. The difference may go deeper than fiscal or economic concerns and into different legal, cultural and other anthropological influences.

3. 1920-1979: The US as a Norm-Maker

3.1 Foundational Ideas and Framework

The foundation of the modern international tax system was created in a century ago under the auspices of the League of Nations (the "League") to resolve conflicts of national income tax laws when such conflicts became evident after World War I. China was a member of the League but apparently played no role in developing the League's work in taxation. The United States was not a member of the League, even though President Wilson was instrumental in the League's establishment. However, American luminaries, such as Edwin R.A. Seligman, T.S. Adams and M. Carroll were instrumental in the work of the League. The US was invited to attend the final session of Expert meeting that finalized the model treaties in 1928.[20]

The theoretical foundation of international taxation is the doctrine of economic allegiance that is presented in a 1923 Report[21] by four economists (Bruins, Einaudi, Seligman and Stamp) to the League. Seligman was the principal author of this report and "mediated successfully between the extreme positions taken by the representatives from capital importing countries (Italy and Belgium) and capital exporting countries (the U.K.)".[22] He was also the intellectual father of the US international tax system, which had profound impact on other countries, such as Canada.[23]

The 1923 Report was the starting point for the League's technical experts and provided a framework for their work that led to the publication of the model treaties in 1928.[24] These models had a lasting impact on double tax treaties as the current OECD Model has many features that can be traced to the League's work. Adams, a "founder of the U.S. system of international taxation"[25] and "the main architect of the FTC [foreign tax credit]"[26] played a role in developing the League's 1928 models as U.S. representative to the League, especially in respect of taxation of business profit and double taxation relief.[27]

Carroll was assistant to Adams in 1927 and 1928, but more importantly the author of "the most important pre-war study of the allocation of income among taxing jurisdictions, as well as a principal mover behind the main limitation on source taxation in the League models, namely the permanent establishment".[28] Carroll could also be considered the promoter of the separate entity approach in applying the arm's length principle (ALP).[29]

The framework created by the League was about reconciling divergent tax systems. It reflects the fundamental hegemony for income tax-based systems (notably the US and the Great Britain). The US comprehensive income tax treaty with Canada in 1942 was considered the "precursor of most modern tax treaties"[30] and the treaty with the Great Britain in 1945 was the turning point in the development of tax treaties.[31]

The idea of creating a plurilateral tax convention was considered and abandoned by the League in the early 1930s. Even though such convention was "desirable", it was not recommended because "the fiscal systems of the various countries are so fundamentally different that it seems at present practically impossible to draft a collective convention, unless it were worded in such general terms as to be of no practical value."[32]

3.2 Transfer Pricing

American leadership continued after the care-taking function of the international tax regime shifted to the OECD. During the postwar and "cold war" period, "the United States became a beacon, or haven, of free enterprise stability, and foreign investors had substantial incentive to invest in the United States," and US enterprises "found substantial opportunity for investing in active business outside the United States."[33] Unlike European companies that use branches for foreign business operations, US-based MNEs used subsidiaries and practised vertical and horizontal integration.[34] The United States became "a substantial importer of "portfolio" investment capital" and "a great exporter of "direct" investment capital."[35] There was a shift towards economic efficiency or neutrality (and in particular, capital export neutrality) and de-emphasis of source-based taxation.[36]

The United States introduced transfer pricing regulations in 1968 and 1969 that "were a radical departure from prior practice in a number of respects", including a determinate hierarchy of transfer pricing methods (i.e., comparable uncontrolled price or CUP, resale price, and cost-plus methods), ostensibly consistent with the separate accounting approach, but had "no explicit antecedents in the League work".[37] "These new methods, however, created the basis for concentrating the residual profit in a single component of the enterprise at will"[38] while under the League's work in the 1930s and 1940s residual profits "would necessarily, if not automatically, be assigned to the "parent" enterprise, on the theory that those profits were in some sense "produced" by central corporate management."[39]

The OECD published its first major work on transfer pricing -- the 1979 Report, *Transfer Pricing and Multinational Enterprise*.[40] This report "is largely based on the US 1968 regulations."[41] "The US was strongly in the forefront of campaigning for a single global standard to relieve the pressures of double taxation on US business."[42]

3.3 The Subpart F (Controlled Foreign Corporations) Rules

To improve neutrality and to improve the US balance of payments, which had deteriorated rapidly as US-based multinationals expanded their operations abroad, Subpart F was introduced in 1962 to end tax deferral on passive income earned through controlled foreign corporations (CFC rules). The main architect of the CFC rules was S.S. Surrey.

> Surrey, like Adams before him, emphasized the role of the U.S. in achieving international cooperation in preventing double nontaxation. His major innovations, Subpart F and the transfer pricing regulations, were copied by other countries and became a new international baseline through the OECD.[43]

4. 1980-2007: China as a Norm-Taker and the US a Reformer

4.1 Overview: Tax Policy Serving National Interests

During the period of 1980-2007, China created an international tax regime by largely borrowing international tax norms and modifying them to suit China's needs, such as attracting foreign investment and exporting Chinese-made products while the Chinese economy underwent a transformation from a command model to a "socialist market" model. China did not openly challenge any international tax norms.

The US continued to lead international tax reforms through primarily reforming its domestic rules. These domestic reforms found their way into the OECD's work and other countries' laws in the areas of transfer pricing.

4.2 China's Introduction of Enterprise Income Tax System

Between 1949-1978, China practised a centrally-planned and controlled economy and had no need for income taxes.[44] Income taxation became necessary when non-state controlled businesses were allowed to operate under the policy of "getting rich is glorious". Foreign investors wanted to know how much tax they must pay before they could predict how much profit they could make from their Chinese investments.[45] The Individual Income Tax and Chinese-foreign Joint Venture Enterprise Income Tax were introduced in 1980, and the Foreign Enterprise Income Tax was introduced in 1981. The two taxes on enterprises became consolidated into the Foreign Investment Enterprise and Foreign Enterprise Income Tax in 1991. Income taxes were also introduced to apply to domestic enterprises, including state-owned enterprises (SOEs). In 2007, a new and consolidated enterprise income tax (EIT) was introduced.[46]

The national tax administration (currently known as the State Tax Administration) has quasi legislative powers and issued normative rules in responsive to tax issues arising from rapid development in business structures, national economic development strategies and international tax development. China developed an expansive tax treaty network with countries that export capital to China as well as countries that receive investment from China.[47]

4.2.1 Transplanting International Tax Principles

China adopted the residence/source tax paradigm. Enterprises established under Chinese laws,[48] such as Chinese-foreign joint ventures or wholly foreign-owned enterprises, were taxable on their worldwide income, while foreign enterprises were taxable on their Chinese-source income. A foreign tax credit mechanism was used to prevent double taxation. Foreign enterprises receiving distributions of profits (or dividends), interest, rent or royalties from China were liable to Chinese withholding taxes.

Transfer pricing rules were first piloted in the Shenzhen Special Economic Zone in 1987, introduced nationwide in 1988 as an administrative rule, and codified in 1991.[49] The 1991 legislation authorizes the use of four transfer pricing methods (i.e., CUP, resale price, cost plus and any other reasonable method).

4.2.2 Tax Policy Emphasis of Attracting Foreign Investment

During the 1980s, enterprise income taxes were not introduced to raise revenue or backstop a progressive personal income tax, but to serve the national strategic interest in attracting foreign direct investment (FDI). Deng Xiaoping made it clear that China's four modernizations need foreign capital, technology and management expertise.[50] A wide range of tax incentives were available to foreign-invested enterprises to encourage FDI in productive activities, special zones, less developed regions, high and new technology and export-oriented businesses. Withholding taxes were reduced for transfer of proprietary technology to China.[51]

4.3 The US Tax Reforms and "Constructive Unilateralism"[52]

4.3.1 The 1986 Tax Reform

The US 1986 tax reform[53] significantly lowered tax rates and broadened the tax base by cutting loopholes with the emphasis on making the US more competitive in attracting investment[54] and US MNEs more competitive globally. The broader context for the reform include: technological and economic changes that put pressure on US hegemony and the apparent decline of the US in the 1970s relative to Japan and Europe,[55] budget deficit and increased mobility of capital, and Ronald Regan was elected on a tax-cutting platform to "make America Great".[56]

The international aspects of the tax reform continued the trend of reducing US source-based taxation of foreign investors, such as the portfolio interest exemption,[57] which led to a world-wide trend toward zero rate withholding tax on interest paid to foreign portfolio investors in the name of attracting mobile capital.[58] Simultaneously, to enhance the competitiveness of US MNEs, US residence-based taxation was reduced through measures such as narrowing the scope of the Subpart F rules (e.g., the banking and insurance exceptions) and extending the 'check the box' rules to foreign entities.[59]

To protect the US tax base, a branch profit tax was introduced in 1986 to remove the tax advantage of using branches over subsidiaries in the US. Earnings stripping limitations on the deductibility of interest were introduced in 1989 to address concerns about foreign debt-financed takeovers of US corporations. Like the earlier FIRPTA (Foreign Investment in Real Property Tax Act) introduced in 1980, these measures targeted foreign investors in real property and business activities as opposed to portfolio investors. On the outbound-investment side, because the foreign tax credit regime allowed US tax to be reduced by foreign taxes paid on foreign income and whether income was foreign-sourced could be "manipulated", the 1986 Act created nine "baskets" of income that were subject to a separate limitation calculation. The passive income basket was broadened to include, generally, dividends, interest, annuities, rents, royalties, and gains from the sales of noninventory assets.[60]

US taxation of income from intangibles became more assertive. For example, the source rules were revised in 1986 in respect of the sale of personal property (including intangibles) from the previous "passage of title" rule to, in essence, the residence of seller rule – income from the sale of personal property by a US resident is US source income. As a result, sale of intangibles of US MNEs is US-sourced. The "super royalty" rule[61] of section 482 explicitly targets US intangibles and was enacted in 1986 to prevent royalty-free transfers of intangibles to entities located in tax havens. The super royalty rule also serves a different role in that the 1968 regulations were designed to bolster U.S. source taxation[62] while the super royalty rule is more about protecting US residence taxation on the conviction that income from US corporations' intangibles belongs to the US tax base.

The 1986 Tax Reform triggered similar tax reforms in US trading partners, including Japan, European countries, Canada and Australia.[63] At the same time, US international tax rules, such as the check the box rules, "led to widespread avoidance of the base company rules by using "disregarded entities"[64] and arguably enabled US MNEs to avoid taxes in market and production jurisdictions. This can be seen in the European state-aid cases involving Starbucks,[65] Apple[66] and Amazon,[67] and the "stateless income" phenomenon that helped trigger BEPS 1.0.

4.3.2 1994 Transfer Pricing Regulations

The super royalty rule introduced in the 1986 Tax Reform is ostensibly inconsistent with the traditional arm's length standard in the 1968 transfer pricing regulations because it is not based on uncontrolled comparables. Such comparables rarely exist as intangibles are generally unique and their monopoly is protected by law. It took almost eight years for the US to finalize new transfer pricing regulations.[68]

The 1994 regulations introduced the "comparable profits method" as an alternative method for valuing transfers of tangible and intangible property. This new method is based on a comparison of the operating profit of the taxpayer with that of independent enterprises with similar types of transactions (or the sector as a whole) under comparable circumstances. It differs from the traditional pricing methods by emphasizing comparison of "profits" as opposed to "price" and is thus more result-oriented and less wedded to rigid transactional pricing comparisons. The 1994 regulations also introduced profit split methods (either comparable profit split or residual profit split). As such, for intangibles, profit will be allocated first to the functions of the parties on the basis of market comparables, with the residual profit allocated to the party who bore the costs of developing the intangibles, whether owned by that party or not. In addition, a "best method rule" was introduced to require use of the method that leads to the most accurate measure of an arm's-length result based on the facts in any particular case. The regulations also introduced tougher penalties and documentation requirements.

The US re-engineering of the transfer pricing regime raised immediate concerns in OECD countries and created "a material schism between the approach in the US and the prevailing OECD thinking on the ALP".[69] There were concerns that the US approach "would unreasonably skew income to the US."[70]

4.3.3 OECD 1995 Transfer Pricing Guidelines

The 1995 OECD Transfer Pricing Guidelines reflect the OECD countries' collective reaction to the US approach. These guidelines reiterate the importance of the arm's length principle but also recognize the reality that highly integrated operations of MNEs make it difficult to always find a single arm's length price. The OECD borrowed from the US concepts such as the arm's length range and economic substance. It also adopted the US profit split method and modified the US comparable profit method into the transactional net margin method (TNMM). The OECD emphasized a "transaction-based" application of these methods as opposed to the US approach that looks at the profit results of the corporation as a whole or industry sector returns. Further, the OECD Guidelines do not go as far as the US super royalty rule in considering further profits and remain "strongly resistant to the use of hindsight".[71] In anticipation of the increase in transfer pricing disputes, the OECD guidelines contain detailed materials on ways of resolving such disputes and mention the possibility of advanced pricing arrangements to prevent disputes.

Even though the OECD guidelines borrowed heavily from the US regulations, the transfer pricing approach started to diverge in the US and other OECD countries. The US approach is more result-oriented and maybe considered by some as "more advanced".[72] But, both the OECD and US rejected the use of formulary apportionment method.

4.3.4 OECD Harmful tax competition (1998) and US Role in Emerging Multilateralism

In 1998, the OECD published its report on *Harmful Tax Competition: An Emerging Global Issue.*[73] Unlike the 1995 Transfer Pricing Guidelines that represented reaction to the US approach, this report reflects the initiative of the OECD, especially its member countries in Europe.[74] This initiative aimed at protecting the tax base of capital exporting countries by targeting preferential tax regimes within OECD member countries as well as tax havens.[75] The US supported it initially but changed its position with the change of administration from President Clinton to President Bush. The Bush Administration supported only the aspect on transparency and the exchange of information. "The U.S. had moved from a champion to a revisionist critic of the OECD efforts early in the Bush Administration, and the most influential actors in the OECD and the EU were obliged to adapt as they could."[76]

Nevertheless, the harmful tax competition project signalled a shift from US unilateralism to international cooperation. It also represented a shift in international tax governance away from technical experts to international politics[77] and a shift in OECD's role from coordinating the prevention of double taxation to reducing tax competition among countries. It may also be the beginning of the decline of US dominance in international taxation.[78]

4.4 China's 2007 Tax Reform

4.4.1 Moving Closer to International Norms

While the US dominance in international tax reforms may be declining at the turn of the century, China's Enterprise Income Tax (EIT) system moved closer to the existing international norms when the Chinese economy became more connected with the global economy and more disciplined by market forces. In addition to functioning as a tax expenditure program, the 2007 EIT became a main revenue raiser as it applied to all forms of enterprises, regardless of ownership.

The 2007 tax reform signals a shift from a system favouring foreign-invested enterprises to one that addresses the international aspects of all types of enterprises. This shift reflects the facts that, among others, Chinese-owned enterprises had begun to make outbound investment, foreign-invested enterprises were competing with Chinese-owned enterprises on the Chinese market (which, in part, resulted from China's commitment to further open its market to foreign companies upon China's accession to the World Trade Organization in 2001) and the existing tax incentives for foreign-invested enterprises became less effective in attracting foreign investment and were open to abuse.[79]

Examples of the internationalization of EIT are: the use of terminology that is more aligned with international tax norms, such as residence, source of income, and effectively connected income; the redesign of tax incentives to replace "ring-fencing" measures to substantive activity-based measures, which could be in response to the Harmful Tax Competition initiative; the introduction of anti-avoidance rules, such as thin capitalization rules, CFC rules, a general anti-avoidance rule (GAAR), and transfer pricing rules that are broadly consistent with the 1995 OECD Transfer Pricing Guidelines.[80]

4.4.2 Protecting China's interest as a source country

The EIT legislation expands the transfer pricing methods to include TNMM and profit split methods. It also allows the use of reasonable methods if an enterprise does not provide information on its related-party transactions or incomplete information. One of the reasonable methods is based on the reasonable proportion of the related party's group profit.

4.4.2 Adopting the Worldwide Corporate Tax System in the name of International Norm

As a burgeoning capital-exporting country, China adopted policies of encouraging "going global". However, instead of adopting the exemption or territorial system, China opted for following the "international common practice" [81] in taxing the worldwide income of residents and preventing double taxation through foreign tax credits. At that time, US was one of few OECD countries with a worldwide system.[82]

5. 2008-present: China as a Norm-Shaker and US a Leader in Multilateralism

5.1 The Global Financial Crisis as a Game Changer

The 2008/2009 global financial crisis is a game changer in terms of China's rise as an influencer in international tax policy. While the US and other OECD countries struggled to manage the crisis, China began to: implement the new EIT system; strengthen the management of international taxation and cooperation; encourage Chinese companies to "go out"; and to maintain China's national tax interests through more effective anti-abuse measures.[83] By 2008, China had become the factory of the world, surpassing the US in participation in global manufacturing [84] and a major market for consumer goods. In 2014-2015 China became a net exporter of capital.

China became more open and assertive about its concerns with the existing international tax norms, especially the ALP and residual profits arising from a source country. China also became more active in global tax governance. "On tax policy, China has been a true global player. It has been an active participant in the OECD-G20 Base Erosion and Profit-Shifting (BEPS) Project, initially as a member of the CFA Bureau Plus in the first phase, and now in the Steering Group of the Inclusive Framework on BEPS."[85]

Meanwhile, the US led a new wave of reforms through introducing, among others, FACTA (Foreign Account Tax Compliance Act) in 2010, GILTI (s global intangible low-taxed income) and BEAT (base erosion and anti-abuse tax) in 2017.[86] FACTA led to the global common reporting standard (CRS) and domestic law changes in Canada[87] and many other countries. The thinking behind GILTI and BEAT led to Pillar Two. The 2021 proposed changes to GILTI and to replace BEAT with SHIELD ((Stopping Harmful Inversions and Ending Low-tax Developments) also shaped Pillar Two.

5.2 China as a Norm-shaker

5.2.1 The ALP and Residual Profits

China’s norm-shaker role is perhaps the most evident in the area of transfer pricing. China found it challenging to apply transfer pricing methods sanctioned in the 1995 OECD Transfer Pricing Guidelines[88] for a lack of uncontrolled comparable transactions. More importantly, the existing methods do not recognize and allocate profit to Chinese subsidiaries regarding location specific advantages (LSAs) in the form of location savings and market premiums (particularly in luxury goods) or intangibles that are developed, enhanced or exploited through activities in China. The existing methods allocate profits to entities that own or control intangibles or risk in terms of creating marketing intangibles and development of technology, but not in connection with the production stage of global value chains (which is located in China). Because Chinese affiliates of foreign MNEs do not legally own or control intangibles or assume risks, they are not allocated any residual profits. That result is not fair.[89] In some cases “the assets and the people should largely dictate where the group’s profits should stay”.[90]

To capture residual profits that should “belong to” China because the value-creation activities are in China, China adopted measures [91] that, in effect, modify the ALP norm. Some notable measures include: to allow the use of group approach in transfer pricing analysis; to incorporate LSAs in conducting comparative analysis and applying TNMM and profit split methods; to consider internal contracts in light of “the capacity to perform the contract, the actual conduct, and “trustworthiness” of the parties”;[92] to adopt a risk based approach that places sufficient regard for the fact that there are sizeable assets located in China” and “the majority of the headcount of” of the business group are based in China; to adopt a broader notion of intangibles;[93] and a contribution analysis may be more suitable than a transactional or profits-based approach so that “remuneration to each party involved would be commensurate with its role and contribution to the value chain in the group.”[94]

More generally, to recognize residual profits derived in the source country, “a global formulary approach should be a realistic and appropriate option” in some cases.[95]

> “Alternatively, the Chinese tax administration may determine the proper return for the headquarters, with the Chinese manufacturer earning the residual profits. Another potential alternative may be to evaluate the Chinese manufacturer on the return on its assets or capital employed, using the group’s results as a comparable for the Chinese manufacturer.”[96]

The overall thinking is profits of entities participating in an MNE’s global value chain should be allocated based on the location where value-creation activities are. China is more prepared to deviate from the international norm. Speaking from a developing country’s perspective, China maintains that such deviations may serve as best practices for other developing countries. The overall stance reflects the taxing interests of a capital-importing country.[97]

Excessive outbound base-erosion payments of royalties and service fees are denied of deductions. Royalties are considered excessive if the intangibles created, enhanced or developed by Chinese affiliates are not taken into account. A commensurate-with-economic-benefits test is adopted as a benchmark – any royalty payment should reflect the economic benefits brought about by the underlying intangibles for the entity.[98] Royalty payments that fail this test will be adjusted for tax deduction purposes, and if the royalty payments result in no economic benefits, then the entire payment is not deductible.[99] This test also applies to intra-group service fees.[100]

5.2.2 Active Role in BEPS 1.0

China seized the opportunity of reforming the international tax norms through BEPS 1.0[101] and advocating the value creation principle.[102] This principle's role is most evident in the Actions 8-10 Report[103] which seeks to align transfer pricing outcomes with the value creation of the MNE group as opposed to the contractual terms of the transaction in order to reduce the incentive for MNEs to shift income to "cash boxes" or other centralized entities located in low-tax jurisdictions. To assist the value-creation analysis and address the information deficiency challenge facing tax administrations, Action 13 Report[104] introduces a minimum standard on country-by-country reporting. The 2017 OECD Transfer Pricing Guidelines reflect the changes stated in the Action 8-10 Report. In this sense, one can say that China was, in fact, a norm-shaker in the area of transfer pricing.

China rapidly implemented the main measures in Action 8-10.[105] It also went further in respect of contribution-based analysis, the commensurate with economic benefits analysis, and the use of global formulary apportionment. Positioning itself as a large developing country, China emphasizes allocating residual profits to production and marketing activities.

5.3 The US Transformative Reforms

5.3.1 2017 Tax Reform

While China's influence appeared to be rising, the US remains a *de facto* influencer and creator of new norms. The US was not an enthusiastic participant of BEPS 1.0 and agreed with the BEPS measures and implemented the minimum standard on country-by-country reporting. It has not actually changed its domestic transfer pricing regulations. The effect of BEPS 1.0 is to strengthen anti-abuse rules to protect the tax base of jurisdictions where value-creation activities take place. US MNEs were the main targets of BEPS 1.0 and would see more of their profits taxable in source countries and potentially less tax in the US after claiming foreign tax credits. BEPS 1.0 measures may also encourage US MNEs to locate more economic activities in low-tax jurisdictions to back up the location of profits in such jurisdictions. Off-shoring investment and productive activities and loss of tax revenues are thus among the significant motivations of the 2017 tax reform.[106]

The 2017 tax reform is the most significant tax reform since 1986. Unlike the 1986 Tax Reform, however, the 2017reform brought the US system closer to the international norm by lowering the nominal rate and adopting a participation exemption system. To protect the US tax base regarding residual profits, a new regime was created through the GILTI and BEAT rules.[107]

5.3.2 The Intangible (Residual) Income Regime

The GITLI regime sits between tangible income that is eligible for exemption treatment and passive income that is subject to current taxation under Subpart F at full US tax rate. It subjects US MNEs' CFC's intangible income (defined as profit exceeding a 20% return on tangible assets) to current US taxation, but at reduced rate[108] and provide relief from double taxation through a foreign tax credit regime on a worldwide basis. For foreign MNEs, the BEAT regime functions as a minimum tax on profits derived in the US through limiting deductions for outbound base-eroding payments, such as royalties and service charges. In effect, the US claims taxing rights over intangible income as a "home' jurisdiction or a market or production jurisdiction, thereby reducing the tax advantages of artificially shifting income to low-tax jurisdictions. Preliminary evidence shows that profit shifting by US MNEs to foreign jurisdictions fell after 2018.[109]

The 2021 proposal would remove the 10% deduction for tangible income and apply the foreign tax credit on a country-by-country basis instead of a worldwide basis. As such, GILTI becomes a minimum tax not just on intangible income, but all residual profits of US MNEs.[110] All lowly-taxed foreign income other than subpart F income can fall within the GILTI regime.

The BEAT imposes a minimum tax[111] on "large corporations" (corporations with average annual gross receipts of at least $500 million over the past three tax years) that make deductible payments to their foreign related parties above a threshold (3% of overall deductions). To avoid reducing US tax competitiveness for research and development, the BEAT rules allow the tax to be reduced by the R&D tax credit.

The SHIELD proposal would broaden the minimum tax by covering any financial reporting groups whose global annual revenues are more than $500 million and denying deduction for cost of goods sold to foreign related parties that are subject to a low effective tax rate. The low effective tax rate would be either the 15% global minimum tax under Pillar 2 or the proposed 21% GILTI rate, depending on which is put in place first.

5.4 The US Leadership in BEPS 2.0

5.4.1 Pivotal Influence

The BEPS 2.0 program was clearly not initiated by the US or represent global efforts to emulate the US approach. Until April 2021 when the US made significant modifications, the two pillars did not seem to stand on solid ground. Since then, the modified pillars have received support, in principle, from the G7, Inclusive Framework and G20 Finance Ministers. The US seems to be back in the driver's seat and both pillars help advance US interests.

5.4.2 Molding Pillar Two in US Image

The GILTI regime is treated as co-existent with Pillar Two's Income Inclusion Rule (IIR).[112] The BEAT or SHIELD rule is similar to the undertaxed payment rule (UTPR) in Pillar Two. The OECD Blueprint on Pillar Two[113] states that the GILTI regime "draws on elements of the BEPS Action 3 Report" even though the Action 3 Report has no measures of this type. There is no doubt, however, that the US rules were the basis for the Pillar Two proposals.[114]

Regardless of the original inspiration of Pillar Two, the US influence on setting the global minimum rate to be at least 15% and forging global consensus is evident in 2021. In fact, the SHIELD regime might just underwrite Pillar Two as base-erosion payments to any low-tax country without Pillar Two would be denied of tax deduction in the US. This may be similar to the use of US domestic rules to underwrite the FATCA and CRS regimes.

5.4.2 De-Americanization of Pillar One

The inspiration for Pillar One came from countries that want to have a Digital Services Tax (DST). Pillar One originally introduces a new nexus and formulary method for allocating residual profits among market jurisdictions, but only for digital and consumer-facing businesses. US MNEs were the primary targets. The US was not keen on supporting it and advocated for a safe harbour exception that was not well received.

The April 2021 US modifications replaced the ring-fencing of digital and consumer-facing businesses scoping with quantitative criteria (e.g., total revenue threshold, profit margin threshold) to determine which MNEs are in scope. They also reduced the number of in-scope MNEs by increasing the threshold for global turnovers.[115]

According to US Treasury Yellen, the modified Pillar One "will be largely revenue neutral for the United States since [the US] will be on both the receiving and giving end of the proposed profit reallocations." Pillar One's impact on US MNEs is thus decreased. It could be said, therefore, that the modified Pillar One is de-Americanized by including non-US MNEs in scope and reducing the pillar's fiscal impact on US.

5.5 China's Ambivalent Stance in BEPS 2.0

5.5.1 Changing stance from BEPS 1.0

China's attitude towards BEPS 2.0 appears to be different from that in BEPS 1.0. In BEPS 1.0, China was one of the key initiators, took credit for advocating the value creation principle, made numerous submissions to the project, and regarded the project as an historic chance for reform to advance the interest of developing countries.[116] In contrast, it is unclear if China has made any submissions to the BEPS 2.0 project. At the time of writing (October 4, 2021), China seems to support the pillars more out of a sense of responsibility as a player in a multilateral process than being a believer in the transformative direction of the pillars.[117]

There could be several explanations. The China-US relations changed after 2016 when the US initiated a "trade war" against China and China became more assertive.[118] China apparently took notice of the US 2017 tax reform and introduced a tax incentive to encourage US MNEs to keep their profits in China.[119] More importantly, perhaps, as its outbound investments grow, China has a growing interest in protecting its MNEs, including digital companies and state-owned enterprises, from double taxation or additional taxes.[120] Examples of this interest are the creation of BRITACOM (Belt and Road Initiative Tax Administration Cooperation Mechanism) in 2019,[121] increasing use of mutual agreement procedures,[122] and moving away from worldwide basis taxation of corporate profit.[123]

There also seems to be a growing sentiment that China is “becoming a significant country in the international landscape of taxation ...ready to shoulder the corresponding international responsibilities.”[124] China appears to want to have a voice in global tax governance in terms of taxing rights over residual profit.[125] It may be biding its time while trying to figure what that voice should be and how it should be expressed in technical tax policy terms. There is a general theme in Chinese commentaries on BEPS 2.0 about the need to better understand the impact of BEPS 2.0 on China and to figure out what technical changes are necessary to advance China’s interest.[126]

5.5.2 Pillar One: Mixed Reaction

Between the two pillars, Pillar One is currently more aligned with China’s interests in enhancing the taxing rights of market jurisdictions.[127] China has endeavoured to allocate more profits to China through innovative application of the ALP (see section 4.4). China also considers global formulary apportionment to be a better method in certain circumstances. Pillar One effectively displaces the transfer pricing analysis and allocates 20% of the residual profit under Amount A to market jurisdictions based on sales and deems a 10% return to marketing and distribution activities under Amount B. China is expected to gain tax revenue.[128]

On the other hand, China is second only to the US in terms of hosting large digital companies and MNEs: while 64% of the Amount A profits belong to companies headquartered in the US, 10% belong to companies headquartered in China, and less than 2.5% belong to Germany, France and Japan.[129] As such, China may be a potential “giver” of tax base when more Chinese MNEs fall within the scope of Pillar One. Very few China-based MNEs under the modified Pillar One would have significant sales outside China and profits exceeding 10%. As such, the amount of profits subject to reallocation is expected to be small in the near future.[130] The assurance that no DSTs will be imposed on sales by Chinese digital companies is also potentially beneficial to China.

The tax certainty process may present challenges to China in terms of ceding control over Chinese tax assessment of in-scope MNEs to the multilateral process. China has been reluctant in adopting tax arbitration.[131]

5.5.3 Pillar Two: Worrisome

Pillar Two is worrisome for some Chinese commentators for several reasons. First, it was made by developed countries for developed countries.[132] Pillar Two was originated from a proposal from Germany and France and is consistent with the overall policy objectives of the European Union and the US. The fact that G7 reached an agreement first seems to confirm that. US

Treasury Secretary Yellen's statement that the G7's agreement was a "big win" for the United States did not escape the Chinese attention.[133]

Weakening the effectiveness of Chinese tax incentives is a major concern.[134] For example, a Chinese affiliate of a US MNE in the qualifying integrated circuit industry may be eligible for a tax holiday,[135] but the "tax room" vacated by China may be occupied by the US under GILTI or Pillar Two, thereby neutralizing China's tax incentive. Pillar Two may also neutralize the effect of another new Chinese tax incentive to attract MNEs to locate their regional hubs in Hainan Free Trade Port.[136]

Pillar Two will likely weaken the strategic importance of Hong Kong for China. Hong Kong's low-rate and territorial-based tax regime and treaty network (including one with China that provides for lower withholding tax rates) make Hong Kong a preferred intermediary jurisdiction for investments into and out of China. China has liberally allowed Chinese MNEs to set up holding companies in Hong Kong to raise capital overseas or making investments, including in Belt & Road jurisdictions. Through the lower withholding taxes on base-erosion payments to Hong Kong resident entities, China has encouraged foreign MNEs to use Hong Kong as an intermediary jurisdiction. As such, "the Chinese government should be thought of as invested in Hong Kong's low-tax system"[137] and China's interest would be adversely affected by Pillar Two.

On the other hand, China already has BEAT-like rules through transfer pricing. Pillar Two may present an opportunity for China to reform its international tax system through switching to the exemption system, updating the CFC regime and introducing GILTI and SHIELD like rules. In the long run, the growth of China-based MNEs may bring China's interest closer to that of the US and make China assume the perspective of capital-exporting countries.

6. The Future: US Hegemonic-Multilateralism Meeting China's True Multilateralism in Global Tax Governance

6.1 Overview

The US leadership in international taxation has historically be one of constructive unilateralism.[138] The Biden administration shows interest in "building" multilateral cooperation in international tax" to "bolster American competitiveness".[139] The US has re-catalysed the BEPS 2.0 process to serve its own interests. For lack of a better term, this new American style is referred to as "hegemonic multilateralism". US domestic GILTI and BEAT/SHIELD are deemed equivalent to Pillar Two. Pillar One's impact on US domestic law is likely less severe than on other countries' laws.

Since becoming a norm-shaker, China has relied on multilateral processes, including the United Nations, G20, and BEPS Inclusive Framework to voice its views.[140] As a general approach, President Xi calls for "improving global governance and practicing true multilateralism".[141] In the BEPS 2.0 process, China has played the role of a good multilateralist by supporting the Inclusive Framework's agreement on the re-catalyzed pillars. As a "responsible major developing country", China has called for more respect to sovereignty and a globally fair and modern international tax system that fosters growth.[142] China has also desired to have "fair and clear rules …to allocate profit retrieved from the tax havens."[143] With respect to BEPS 2.0, however, it is difficult to gage the actual meaning of "true multilateralism" at the moment of writing.

Will the Chinese true multilateralism coincide with the American-centric multilateralism? There are no clear signs that China will implement the two pillars, even if China supports a high-level agreement in a political or diplomatic sense. As part of China's overall global strategy and fiscal policy, implementation of the two pillars involves considerations that are much more than just amending domestic laws and signing a multilateral tax convention. If the MLI to implement BEPS 1.0 is of any precedence, China signed, but not yet ratified the convention. Understanding the areas of converging and diverging interests in the two countries may shed some light on the path for the future.

6.2 Convergence in Interests

The underlying economic realities may pre-determine the two countries' tax positions. The two countries' economies are intertwined. Because of the significant investment in China by US MNEs, what is good for the Chinese economy may also be good for the US.[144] As major market jurisdictions, both stand to gain new taxing rights under Pillar One, although China would gain more in the near future as more US MNEs would be taxable than Chinese ones. What US may lose under Pillar One would be more than compensated by revenue gains under Pillar Two as US MNEs presumably have more income that is not currently taxed at the minimum rate.

Both countries have recently moved closer to the international tax norm by adopting the territorial system, reflecting the concerns for competitiveness of their MNEs. Meanwhile, both have taken measures to prevent offshoring-profit. In the area of transfer pricing, both countries have adopted a more substance-over-form approach, a broad notion of intangibles and unconventional ways of capturing residual profits (e.g. super royalty rule in the US and contribution-based or value-creation methods in China).

Presumably, it is in both countries interests to have a coordinated global tax arrangement that can minimize the transaction costs for MNEs while accommodating the fiscal needs of capital-importing countries. It is likely not in either country's interests to have different "regional" schemes for taxing MNEs that compete on a global basis.

6.3 Divergence in Approach and World View

The general approach to international tax reforms or global tax governance appears to differ between China and the US. As a hegemonic power and "technical innovator" in taxation, the US has, until BEPS 2.0, generally practiced unilateralism. Other countries have followed the US lead out of their own interests in a manner that is presumably similar to what China did in the 1980s and 1990s. As a latecomer, China has been biding its time. It has recently sought to change the existing norms through multilateralism as an advocate for developing countries.[145] China identifies fairness as a key objective for international tax reform. In other words, the Chinese approach is not explicitly about China's own interests, which differs from the America First approach. China has attempted to "strike a balance between conforming to international conventions while being able to deal with some unique issues…"[146]

On the core issue of which country can tax MNEs' residual profit, China appear to have different views from the US. Through GILTI, the US appear to believe that US MNEs' residual profit (as well as lowly-taxed routine profit) belongs to the US. China does not have GILTI-like rules and has not even enforced its CFC rules as rigorously as the transfer pricing rules. China seems to think more like a source country or Factory of the World. China emphasizes the contributions by people and assets to earning residual profit, as opposed to capital and technology that are embodied by corporate residence. China may prefer to have the residual profit shared by all participating jurisdictions under a global formulary apportionment method on the ground that all constituent members of a MNE group, no matter now they are configured legally, contribute to and share the collective outcome even if their direct contributions are routine.

China is also more guarded about sovereignty. The Century of Humiliation (1839-1949) is often a reminder of China's need to be independent and to avoid falling behind the Western powers.[147] The US has no similar experience. As such, when Pillar Two effectively treats national corporate tax bases as "fungible"[148] and authorizes the residence country to tax income that is chosen by another country not to tax, fiscal sovereignty can be a real concern for China.

Conclusions

The US has been the main architect of the current international tax system. It is difficult to find a basic principle that does not have any American influence. China has bided its time: learning from "advanced countries" (including the US); modifying international norms for Chinese unique conditions; and revisiting those norms from the position of a major economic powerhouse in the context of digitalisation. On the battleground for taxing rights over residual profit, which is what BEPS 2.0 is about, the two countries do share some common interests, but also have different approaches and emphases.

In terms of international tax governance, it is easy to see China's influence rising, but that does not necessarily mean America's influence declining. However, it does appear that American exceptionalism or America-centric multilateralism needs to contend with China's uniqueness or true multilateralism.[149] The trajectory is likely more open confrontation. Until 2013, China had never openly challenged the US leadership role.[150] In BEPS 1.0, China and other countries relied on the value creation principle to backstop stronger anti-abuse rules to prevent MNEs (most of which are US-based) from eroding source-countries' tax base. In BEPS 2.0, China may acquiesce at first and bide its time for specific counter measures.

What China wants matters. Research seems to suggest, however, that decoupling of international tax norms is unlikely at the moment or in the near future. China's collaboration with OECD continues and the China-led BRITCOM focuses on improving tax administrative cooperation as opposed to substantive tax policy.

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[1] For selected works of Deng Xiaoping, see https://dengxiaopingworks.wordpress.com/2013/02/25/carry-out-the-policy-of-opening-to-the-outside-world-and-learn-advanced-science-and-technology-from-other-countries/ (hereinafter "Deng's Works").

[2] See "40 Years of Friendship from the Personal to the Political: President Carter reflects on our nation's – and his own – relationship with China," https://www.cartercenter.org/news/features/p/china/president-carter-on-normalizing-relations-with-china.html

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[3] See Winston Ma, *The Digital War: How China's Tech Power Shapes the Future of AI, Blockchain and Cyberspace* (WILEY 2021).
[4] "Speech by Xi Jinping at a ceremony marking the centenary of the CPC [Chinese Communist Party]", http://www.xinhuanet.com/english/special/2021-07/01/c_1310038244.htm
[5] Xinhua, "Senior Chinese Official tells U.S. to stop interference, avoid confrontation", March 19, 2021, http://www.xinhuanet.com/english/2021-03/19/c_139822014.htm
[6] President Joe Biden's speech at a joint session of Congress on April 28, 2021; and "Biden Wants Higher Taxes than China's," *Wall Street Journal*, Opinion, May 4, 2021, https://www.wsj.com/articles/biden-wants-higher-taxes-than-chinas-11620167575
[7] David Lynch, "Biden set for G-7 boost in bid for all nations to impose minimum global corporate tax," *Washington Post*, June 1, 2021, https://www.washingtonpost.com/us-policy/2021/05/31/global-minimum-corporate-tax-biden-g7/
[8] Xinhua, supra note 5.
[9] Lingling Wei and Bob Davis, "China's Message to America: We're an Equal Now," *The Wall Street Journal*, April 12, 2021, https://www.wsj.com/articles/america-china-policy-biden-xi-11617896117
[10] For an overview, see the Statement by the OECD/G20 BEPS Project, https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf
[11] For other ways of divide the history of the international tax system, see Eduardo Baistrocchi, "The International Tax Regime and Global Power Shifts," 40 *Va. Tax Rev.* 219 (2021); Reuven S. Avi-Yonah, "All of a Piece Throughout: The Four Ages of U.S. International Taxation" 25 *Va. Tax Rev.* 313 (2005-2006) (hereinafter "Avi-Yonah, Four Ages"); and China International Tax Research Institute, *Accompanying Reform and Open Policy: 40 Year History of Chinese International Taxation* (hereinafter "China 40-Year Tax History") (in Chinese).
[12] *See* Edward D. Kleinbard, *We Are Better than This: How Government Should Spend Our Money* (Oxford University Press,2015); and J. Scott Wilkie, "The Way We Were? The Way We Must Be? The 'Arm's Length Principle's Sees Itself (for What It Is) in the "Digital' Mirror", 47 *Intertax* 12, 1087 (2019).
[13] J. Scott Wilkie, "David Rosenbloom: A Custodian of the First and Continuing "Real" Model Tax Treaty" in Georg Kofler, Ruth Mason and Alexander Rust, eds. *Thinker, Teacher, Traveler: Essays in Honor of H. David Rosenbloom* (IBFD 2021), ch.51 (hereinafter "Wilkie 2021"), at 665.
[14] Ibid., at 666.
[15] Organization for Economic Co-operation and Development, *Harmful Tax Competition: An Emerging Global Issue* (April 9, 1998).
[16] Convention on Mutual Administrative Assistance in Tax Matters (2010) (144 jurisdictions participating as of August 2021) https://www.oecd.org/tax/exchange-of-tax-information/convention-on-mutual-administrative-assistance-in-tax-matters.htm
[17] https://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/.
[18] Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI), https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm

[19] Baistrocchi, supra note 11; Reuven Avi-Yonah, "Constructive Unilateralism: U.S. Leadership and International Taxation" 42 *Int'l Tax J.* 17 (2016) (hereinafter Avi-Yonah 2016).
[20] *See* Sunita Jogarajan, *Double Taxation and the League of Nations (*Cambridge University Press, 2018), at 103.
[21] Report on Double Taxation submitted to the Financial Committee — Economic and Financial Commission Report by the Experts on Double Taxation — Document E.F.S.73. F.19 (April 5th, 1923) (hereinafter the "1923 Report").
[22] Avi-Yonah, Four Ages, supra note 11, at 322. Seligman also shaped the development of international taxation through his writings, such as Edwin Seligman, *Double Taxation and International Fiscal Cooperation* (Macmillan, 1928).
[23] Collin Campbell and Robert Raizanne, "The 1917 Income War Tax Act: Origins and Enactment" in Jinyan Li, J. Scott Wilkie and Larry Chapman, eds., *Income Tax at 100 Years: Essays and Reflections on the Centennial of the Income War Tax Act* (Toronto, Canadian Tax Foundation, 2017) ch.2.
[24] *See* Jogarajan, supra note 20.
[25] Michael J. Graetz & Michael M. O'Hear, "The "Original Intent" of U.S. International Taxation," *46 Duke L.J*, 1021 (1997), at 1027.
[26] Avi-Yonah, Four Ages, supra note 11, at 318.

[27] Graetz and O'Hear, supra note 25, at 1066-89. Adams attended the final session of 1927 Experts meeting and was successful in making several amendments to the draft model convention; see Jogarajan, supra note 20, at 103, 171-81.
[28] Avi-Yonah, Four Ages, supra note 11, at 323.
[29] Richard S. Collier and Joseph L. Andrus, *Transfer Pricing and the Arm's Length Principle after BEPS* (Oxford University Press, 2017), 29-36.
[30] Robert Raizenne and Colin Campbell, "The Origins and Architecture of the 1942 Canada-United States Income Tax Treaty," in *Studies in the History of Tax Law*, Vol.9, ch.15 (Hart Publishing, 2019).
[31] Picciotto, S., *International Business Taxation* (Weidenfeld and Nicolson, 1992).
[32] League of Nations Fiscal Committee: Report to the Council on the Work of the Third Session of the Committee C.415.M.171.1931.II.A.; see "History of Tax Treaties", https://www.taxtreatieshistory.org/ (visited on February 19, 2021). The same ideas are found in the report submitted by the General Meeting of Government Experts (document C.562.M.178.1928.II).
[33] Stanley I. Langbein and Max R. Fuss, "The OECD/G20-BEPS-Project and the Value Creation Paradigm: Economic Reality Disemboguing into the Interpretation of the 'Arm's Length' Standard" (2018) 51:2 *The International Lawyer* 259-409, at 311.
[34] Ibid.
[35] Ibid.
[36] Avi-Yonah, Four Ages, supra n. 11, at 324.
[37] Langbein and Fuss, supra note 33, at 314.
[38] Ibid.
[39] Ibid., at 315.
[40] OECD, *Transfer Pricing and Multinational Enterprises, Report of the OECD Committee on Fiscal Affairs* (Paris: OECD, 1979).
[41] Collier and Andrus, supra note 29, at 62.
[42] Ibid., at 62.
[43] Avi-Yonah, Four Ages, supra note 11, at 328.
[44] For more history of the Chinese income tax system, *see* Jinyan Li, *Taxation in the People's Republic of China* (Praeger, 1991); and Alexander J. Easson and Jinyan Li, *Taxation of Foreign Investment in the People's Republic of China* (Kluwer, 1989).
[45] China 40-Year Tax History, supra note 11, at 5-6.
[46] *See* Jinyan Li, *International Taxation in China: A Contextualized Analysis* (IBFD, 2016) (hereinafter "Li 2016").
[47] For a list of Chinese tax treaties, see http://www.chinatax.gov.cn/eng/c101276/c101732/index.html
[48] The term "residence" was used for the first time in the EIT law in 2007. Article 3 defines this term by reference to place of incorporation and place of effective management. *See* Li 2016, supra note 46, at 77-79.
[49] *See* China 40-Year Tax History, supra note 11, at 295-6.
[50] Deng Xiaoping, "Carry Out the Policy of Opening to the Outside World and Learn Advanced Science and Technology from Other Countries", October 10, 1978, Deng's Works, supra note 1.
[51] See Li 2016, supra note 46.
[52] "Constructive unilateralism" is used in Avi-Yonah 2016, supra note 19 to describe the US style of influencing international tax reforms.
[53] Pub. L. No. 99-514, 1231(e)(1), 100 Stat. 2085.
[54] James A. Baker, III, "The Momentum of Tax Reform" in Herbert Stein ed. *Tax Policy in the Twenty-first Century* (John Wiley & Sons, 1988), 1-9.
[55] Giorgio Romano Schutte, "The challenge to US hegemony and the "Gilpin Dilemma", *Revista Brasileira de Politica International* (2021), http://dx.doi.org/10.1590/0034-7329202100104, at 2.
[56] Baker, supra note 54, at 3: "It will be one of President Regan's chief legacies that the top tax rate on the world's largest economy dropped from 70 percent to less than half that within a few short years."
[57] Introduced in 1984, I.R.C. s.871(h). Other measures include the safe harbour for passive investors in securities and commodities (IRC s.864(b)(2)).
[58] Avi-Yonah, Four Ages, supra note 11, at 333.
[59] Ibid.
[60] Ibid.
[61] In the case of transfer (or license) of intangible property, the income with respect to such transfer or license must be commensurate with the income attributable to the intangible.
[62] Avi-Yonah, Four Ages, supra note 11, at 329.

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[63] Bert Brys, Stephen Mattews and Jeffrey Owens, "Tax Reform Trends in OECD Countries" (OECD, 2011).
[64] Avi-Yonah, Four Ages, supra note 11, at 333.
[65] Cases T-760/15 *Netherlands v Commission* and T-636/16 *Starbucks and Starbucks Manufacturing Emea v Commission*.
[66] Case number: T-778/16, T-892/16, *Commission v. Ireland.*
[67] T-816/17 *Luxembourg v Commission* and T-318/18 *Amazon EU v Commission.*
[68] See Langbein and Fuss, supra note 33; Reuven Avi-Yonah, "The Rise and fall of the Arm's Length: A Study in the Evolution of U.S. International Taxation," 15 *Va. Tax Rev.* 89, 147-148 (1995); Collier and Andrus, supra note 29 , at 72-78.
[69] Collier and Andrus, ibid., at 79.
[70] Ibid., at 78.
[71] Ibid., at 82.
[72] Langbein and Fuss, supra note 33, at 331.
[73] Organization for Economic Co-operation and Development, *Harmful Tax Competition: An Emerging Global Issue* (April 9, 1998).
[74] *See* J. H. Mutti, *Foreign Direct Investment and Tax Competition (*Washington, DC: Institute for International Economics, 2003) at 87-88.
[75] Hugh Ault was regarded as the "main theoretician behind this initiative; *see* Avi-Yonah, Four Ages, supra note 11, at 335. Jeffrey Owen was a key player: see Andrew P. Morriss and Lotta Moberg, "Cartelizing Taxes: Understanding the OECD's Campaign against Harmful Tax Competition", 4 *Colum. J. Tax L.* 1 (2012) at 42-56.
[76] Robert T. Kurdle, "U.S. Defection from the OECD "Harmful Tax Competition" Project: Rhetoric and Reality" (2005), Working Paper, Matthey B. Ridgway Center, at 3.
[77] Morriss and Moberg, supra note 75.
[78] Kurdle, supra note 76, remarks: "But O'Neill's handling of the OECD's tax competition project typified the Bush administration by placing U.S. interests on a vastly different plane from others' in both words and actions. As such, it made a small but still damaging contribution to the collapse of European confidence in American leadership."
[79] *See* China 40-Year Tax History, supra note 11; Li 2016, supra note 46.
[80] Yaobin Shi, Ruibiao Sun and Zhao Liu, eds. *The Enterprise Income Tax Law of the People's Republic of China: Interpretation and Application Guide* (Law Press, China, 2007), at 21-30.
[81] Ibid., at 91.
[82] Thornton Matheson, Victoria Perry and Chandara Veung, "Territorial vs. Worldwide Corporate Taxation: Implications for Developing Countries" IMF Working Paper, WP/13/2015.
[83] China 40-Year Tax History, supra note 11, at 82.
[84] Schutte, supra note 55, at 7.
[85] Mr. Angel Gurría, Secretary-General of the OECD, was in Beijing from 24 to 26 March 2018 to attend the China Development Forum, at https://www.oecd.org/china/chinas-fiscal-and-tax-reform-global-perspective-march-2018.htm
[86] Pub. L. No. 115-97, December 22, 2017.
[87] Canada, Income Tax Act, Part XVIII and Part XIX.
[88] *United Nations Practical Manual on Transfer Pricing for Developing Countries* (2013) (2017) and (2021), Part D, Country Practices. Citations below are to the 2021 edition (hereinafter referred to as "UN Transfer Pricing Manual - China").
[89] The term "fair" is used several times in UN Transfer Pricing Manual -China, supra note 88.
[90] UN Transfer Pricing Manual -China, supra note 88, section 2.23.3.
[91] Ibid., section 2.22.2; State Tax Administration, "[2016] No. 64, Public Notice on Matters Regarding Enhancing the Administration of Advance Pricing Arrangements" (hereinafter "STA Public Notice [2016] No. 64"); "[2017] No. 26, Public Notice on Clarifying the Filing Standards of "People's Republic of China Enterprise Annual Reporting Forms for Related-Party Transactions" (hereinafter "STA Public Notice [2017] No. 26"); "[2017] No. 6, Public Notice on Issuing the Administrative Measures for Special Tax Investigation and Adjustment and Mutual Agreement Procedures" (hereinafter "STA Public Notice [2017] No. 6").
[92] STAT Publice Notice [2017] No.6, ibid., art. 15(3).
[93] Ibid., section, 2.21. Technology intangibles include technical know-how and business processes that were improved by Chinese entities through "trial and error". Marketing intangibles include global brand names that are "localized" for the unique Chinese market conditions (such as cultural preferences and language). An example is the localization of a shampoo brand "Head and Shoulders" as "Ocean Flying Silk" (*hai fei si* in Chinese pinyin).
[94] UN Transfer Pricing Manual-China, supra note 88, section 2.23.3

[95] Ibid. China is the first country that officially supports a global formulary allocation method: Langbein and Fuss, supra note 33, at 398.
[96] UN Transfer Pricing Manual-China, supra note 88, section 2.23.4.
[97] Ibid.
[98] STA Public Notice [2017] No.6, supra note 91, art.32.
[99] Ibid.
[100] The Chinese State Administration of Taxation submitted a letter to the UN Working Group on Transfer Pricing Issues Chinas views on service fees and management fees in April 2014. See Conrad Turley, David Chamberlain and Mario Petriccione, *A New Dawn for the International Tax System Evolution from past to future and what role will China Play?* (IBFD 2017), at 302-12.
[101] China 40-Year Tax History, supra note 11, at 86.
[102] The value creation principle was among the numerous proposals made by China during the BEPS 1.0 process; see Xiaojing Cui, *A Study on Legal Issues Related to China's Participation in Global Tax Governance* (China Social Science Press, 2021), at 237-264 (in Chinese), at 12.
[103] OECD/G20 BEPS Project, Aligning Transfer Pricing Outcomes with Value Creation (2015 Final Reports).
[104] OECD/G20 BEPS Project, Transfer Pricing Documentation and Country-by-Country Reporting (2015 Final Report).
[105] STA public announcements, such as notes in supra note 91, function as laws.
[106] United States, Congressional Research Service, *Issues in International Corporate Taxation: The 2017 Revision* (P.L. 115-97), updated August 27, 2021, https://crsreports.congress.gov R45186 (hereinafter the "CRS Report"), at 1.
[107] The 2017 tax reform also introduced FDII (Foreign Derived Intangible Income) rules to incentivize MNEs to own intangibles in the US and "export" the intangibles. The Biden Administration proposed to repeal FDII. As such, FDII rules are not discussed in this article.

[108] Under the 2017 GILTI rules, income of foreign subsidiaries (CFCs) in excess of a deduction for 10% of tangible assets minus interest costs is taxable to the US parent, but at a reduced rate. Foreign tax credits are allowed for 80% of foreign taxes paid. As a result, a residual US tax is imposed when foreign tax rates are below 13.125% in the initial years (0.105/0.80) and subsequently 16.406% (0.13125/0.80). GILTI rules do not apply to income of CFCs in countries where the tax rate is 90% or more of the US tax rate (the high-tax kickout rule).
[109] Penn Wharton Budget Model, "Profit Shifting and the Global Minimum Tax", July 21, 2021 (hereinafter the "UPenn Study").
[110] For transfer pricing purposes, the concept of "intangibles" was broadened to include goodwill, going concern value, the value of workforce in place.
[111] The tax rate was 5% in 2018 and 12.5% for tax years beginning after 2025.
[112] OECD/G20, *Pillar Two Blueprint*, para.25.
[113] OECD/G20 BEPS Project, Action 3 2015 Final Report – Designing Effective Controlled Foreign Company Rules. It considers income from using intangible property in the context of excess profits and suggests that it can be part of CFC's income, see 4.2.3.
[114] Brian J. Arnold, "The Evolution of Controlled Foreign Corporation Rules and Beyond," *BIT*, December 2019, 631, at 642.
[115] Pillar One Blueprint suggests that about 2,300 businesses were targeted. The US modification target only the largest 100 MNEs.
[116] China 40-Year Tax History, supra note 11, at 77.
[117] Foreign Affairs spokesperson, Mr. Wang Wenbin, addressing the media on July 2, 2021, Jhttps://news.hangzhou.com.cn/gjxw/content/2021-07/03/content_8000039.htm
[118] See Rasmus Christensen and Martin Hearson, "The Rise of China and Contestation in Global Tax Governance", SocArXiv pzvy3, Center for Open Science, DOI: 10.31219/osf.io/pzvy3
[119] State Taxation Administration Public Notice on the Matter Regarding the Scope of Temporary Exemption of Dividend Withholding Tax on Non-resident Investors That Reinvest the Dividends in China", October 29, 2018.
[120] Christensen and Hearson, supra note 118, at 12-13.
[121] For a statement about BRITACOM, see https://www.britacom.org/zchj/qwfb/202002/t20200228_1098051.html. It should be noted that the author of this paper is a member of the Advisory Board of BRITACOM, but her views do not in any way represent those of BRITACOM.
[122] See Cui, supra note 102, at 237-64.

[123] Ministry of Finance and State Taxation Administration, "Notice Regarding Preferential Enterprise Income Tax Policies for the Hainan Free Trade Port,"*Caishui* [2020] 31 (June 23, 2020).
[124] Wang Li, "Modernization of China's International Taxation", International Taxation in China, (2016(5): 72-81. See also Liping Deng, "International Tax Governance and the BRITACOM." *International Taxation in China* 2019 (4): 12–18. https://doi.org/10.19376/j.cnki.cn10-1142/f.2019.04.002.
[125] China 40-Year Tax History, supra note 11, at 424.
[126] E.g., Xiaojing Cui and Yuan Li, "OECD Pillar Two: Challenges and Responses", International Taxation in China 2021 (9); Yuesheng Jiang and Yirang Jiang, "Process, Fatal Points and Responses: An Analysis and Examination of OECD Pillar One", *International Taxation in China*, 2020 (12) Part 1, 2021(1) Part 2 and 2021(2) Part 3; Tizhong Liao, "Globalization and International Tax Reform", *International Taxation in China*, 2021 (8); Zhiyong Zhang and Heling Li, "Digital Economy, Value Creation and Wealth Distribution – A Taxation Perspective", *International Taxation in China*, 2021 (9); Guangyao Zhu, "We should Study US Tax Policy Reforms and their Impact on Global Tax Systems and Economic Patterns and Come Up with Responding Policy Options in the Post-COVID Era", July 5, 2021, https://mp.weixin.qq.com/s/SyQzAAPf_SJZouO9CPWcGQ; and Xiaodan Zhu and Gangshan Cao, "The Changes and Impact of the Purpose of Two Pillar Framework Agreement," *International Taxation in China*, 2021 (9) (all in Chinese).
[127] Jiang and Jiang, ibid.
[128] For example, Martin A. Sullivan, "OECD Pillar 1 'Amount A' Shakes Up Worldwide Profit", Tax Notes Federal, Feb.24, 2020; and Robert Goulder, "The Cost of Change: Pillar 1 Reduced to the Back of a Napkin", *Tax Notes Int'l*, Vol.103, July 5, 2021 111-8.
[129] Michael Devereux and Martin Simmler, "Who Will Pay Amount A?" July 2021, EconPol Policy Brief.
[130] Zhu and Cao, supra note 126.
[131] China has opted out of the arbitration clause in the MLI.
[132] Research shows that residual profit from intangibles is concentrated in OECD countries: 38.4% in US; 12.4% in the Netherlands, 11.2% in Japan, 6% in UK, 5% in Switzerland, 4.7% in Germany, 4.6% in France, 2.7% in Sweden, 2.3% in Ireland, 1.9% in Korea, and 10.9% in China and all other countries combined. See, C. Durand and W. Milberg, "Intellectual Monopoly in Global Value Chains," *Review of International Political Economy*, 2019(5): 1-26.
[133] Zhu, supra note 126.
[134] Cui, supra note 102; Zhu and Cao, supra note 126.
[135] On 11 December 2020, the Ministry of Finance (MOF), STA and other agencies jointly issued "Bulletin 45 on Enterprise Income Tax Policies regarding the Stimulation of High-quality Development of Integrated circuit and Software Enterprises". This tax incentive is intended to strengthen China's capacity in this sector, following US sanctions that cut off access to American processor chips for Chinese companies such as Huawei. See Associated Press, "China Cut Taxes to Spur Semiconductor Development", March 29, 2021, https://www.usnews.com/news/business/articles/2021-03-29/china-cuts-taxes-to-spur-semiconductor-development
[136] MOF and STA, "Notice Regarding Preference Enterprise Income Tax Policies for the Hainan Free Trade Port,"*Caishui* [2020] 31 (June 23, 2020). Qualifying enterprises are eligible for three tax preferences: a reduced enterprise income tax rate of 15%; expensing or accelerated deduction of eligible capital expenditure; and exemption from Chinese tax for foreign-source income, representing China's shift from a comprehensive regime of taxing foreign income to an exemption regime. Even though the nominal rate is 15%, this tax incentive may be neutralized if the effective tax rate computed under Pillar Two is lower.
[137] Wei Cui, "What Does China Want from International Tax Reform", *Tax Notes Int'l*, July 9, 2021, at 12/20.
[138] Avi-Yonah 2016, supra note 19.
[139] U.S. Department of the Treasury, *The Made in America Tax Plan*, April 2021.

[140] Cui, supra note 102. See also, Reuven S. Avi-Yonah and Haiyan Xu, "China and the Future of the International Tax Regime" (2017). Law & Economics Working Papers. 140. https://repository.law.umich.edu/law_econ_current/140; Christensen and Hearson, supra note xx.
[141] Xinhuanet, "Xi calls for practicing true multilateralism", Sept.22, 2021, http://www.news.cn/english/2021-09/22/c_1310201342.htm
[142] UN Transfer Pricing Manual -China, supra note 88, section 2.1.2.
[143] Ibid., section 2.1.3.
[144] Schutte, supra note 55, at 10, stating that in 2018, about two-thirds of Chinese exports to the US were organized by foreign companies, most of which part of US MNE groups.
[145] China 40-year Tax History, supra note 11, at 77.

[146] UN Transfer Pricing Manual -China, supra note 88, section 2.11.2.

[147] "After the Opium War of 1840, however, China was gradually reduced to a semi-colonial, semi-feudal society and suffered greater ravages than ever before. The country endured intense humiliation, the people were subjected to great pain, and the Chinese civilization was plunged into darkness. Since that time, national rejuvenation has been the greatest dream of the Chinese people and the Chinese nation." See "Speech by Xi", supra note 4.

[148] Scott Wilkie, "Reflecting on the OECD's July 1 "Two-Pillar Plan" Announcement, https://tax.osgoode.yorku.ca/, July 9, 2021.

[149] UN Transfer Pricing Manual -China, supra note 88, section 2.11.2.

[150] Baistrocchi, supra note 11, at 245.