

Research on the Influence of MNEs' M&A in China and the Anti-tax Avoidance System

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Abstract. With the development of economic globalization, China's policies and means to attract foreign investment continue to optimize. The use of cross-border M&A means for foreign investment is gradually increasing, a large number of related party transactions will produce a series of taxes avoidance. The purpose of this essay is to improve and optimize China's anti-tax avoidance regulatory system. This essay will analyze the development of China's anti-tax avoidance, the actual challenges China faces due to the upgrading of the national industrial structure, and compare with the overall international anti-tax avoidance situation to find out the proper regulations. At the same time, cases in developed countries will be used to optimize China's anti-tax avoidance of multinational companies. This essay draws the improvement measures for China's current anti-tax avoidance system. First of all, the general anti-tax avoidance system should be improved and clarified. Secondly, the regulatory supporting facilities need to be optimized. International cooperation and the norms of bilateral agreements should also be optimized synchronously.

Keywords: Anti-tax Avoidance; Multinational Enterprises; Supervision.

1. Introduction

With the development of "the Belt and Road" and the increase of foreign investments, transnational mergers and acquisitions have become one of the main means of utilizing foreign investment in China. Meanwhile, the deepening of mergers and acquisitions in China will inevitably lead to tax avoidance. To maintain China's tax rights, interests, and national sovereignty based on economic development, considering the lag of the law may lead to a lack of judgment on the new situation, which can be an important topic to optimize the supervision of tax avoidance.

Current scholars' opinions on the optimization of China's anti-tax avoidance system mainly include improving the monitoring of tax sources [1-4], improving the individual income tax system and joining the anti-tax avoidance system to avoid malicious overseas tax avoidance [5-7], optimizing the level of supporting facilities and workforce [8], attracting advanced talents [9], and strengthening the international cooperation in anti-tax avoidance collection and management [10-14].

This essay will start from China's anti-avoidance system development process, considering Chinese characteristics analysis of anti-avoidance system regulation and the reasons for the system, taking into account the current international situation. At the same time, the essay will take the anti-avoidance regulation cases of the developed countries as the foundation, analyze the international anti-avoidance regulation risks in China and find out the proper solutions.

2. The current situation of MNEs' mergers and acquisitions in China and its risks to China

2.1 The current situation of MNEs' mergers and acquisitions in China

Cross-border mergers and acquisitions have gradually become the main form of foreign direct investment. According to the proportion of wholly foreign-owned enterprises in China's foreign investment and the data from Shanghai Statistics Bureau, the main body of foreign direct investment in Shanghai were wholly foreign-owned enterprises from January to February 2022. From January to February, 483 wholly foreign-owned enterprises were newly established in Shanghai, accounting for 58.5% of the total number of newly established foreign-owned enterprises. The realized amount was

3.598 billion US dollars, 19.1% more than the same period last year, accounting for 79.3% of the total realized amount in the city. [1]

2.2 The main tax avoidance methods of MNEs arising from the deepening of mergers and acquisitions in China

Generally speaking, the traditional tax avoidance behaviors of multinational enterprises in China include hiding tax avoidance behaviors by designing related party transactions, sharing costs by stripping functional risks, and transferring profits. [3] At the same time, due to the diversification and complexity of the transaction activities of multinational enterprises, the tax avoidance methods in China have also become diverse. They are no longer limited to traditional transfer pricing methods, cost-sharing or the creation of Apple company. Instead, it uses new methods such as contracts and equity structure changes to conduct tax avoidance planning, [4, 6] which also brings new challenges to China's anti-tax avoidance supervision.

2.3 Under the existing transnational tax avoidance method, the specific risks that states face

With the entrance of MNEs, those MNEs bring capital, advanced technology, and management skills for economic development to hosting states, which can increase the employment opportunities and can be helpful to the overall management ability and economic level improvement of host states. Meanwhile, the entry of MNEs sometimes may cause adverse effects such as crowding the domestic market, impacting the national economy, or threatening national sovereignty. The tax avoidance of MNEs harms the economic interests of the host state and enables these MNEs to have stronger market competitive advantages, which is not conducive to the development of domestic enterprises. Due to these kind of situations, certain regulations need to be carried out. [8]

2.4 The status of China's anti-tax avoidance system

China's anti-avoidance measures against multinational enterprises mainly exist in three stages, including the initial stage, the development stage, and the optimization stage. The initial stage mainly refers to the period from 1987 to 2007, when Shenzhen Special Economic Zone issued the Interim Measures on Tax Administration of Transaction Business of Foreign Invested Enterprises and Affiliated Companies in Shenzhen Special Economic Zone, marking the beginning of the supervision of tax avoidance of multinational corporations from the legal level. In 1991, for the first time, China tries to regulate transfer pricing between affiliated enterprises.

The development stage is from 2008 to 2014, and in 2008, China implemented the Enterprise Income Tax Law of the People's Republic of China and its implementation regulations. For the first time, China's anti-tax system introduced the cost-sharing agreement, capital weakening, controlled foreign enterprises, general anti-tax avoidance, and tax adjustment on tax avoidance plus interest.

At present, China's anti-tax avoidance measures are in the optimization period. On January 1, 2015, the Measures for the Administration of Individual Income Tax on Equity Transfer Income (Trial) was officially implemented. So far, China's anti-tax avoidance legal system has been formed. However, due to the lag of the law and the continued entry of multinational companies into China's market, the emergence of new tax avoidance methods of multinational companies will also bring new challenges to China's anti-tax avoidance supervision. [11]

3. China's transnational tax avoidance supervision status and deficiencies

3.1 The reasons for optimizing our country's anti-tax avoidance system for the multinational corporation supervision system

3.1.1 Lack of supporting facilities for anti-tax avoidance system

Since China acceded to the WTO, it has accelerated the process of integration, marketization, and globalization of the world economy, which constantly improved the environment for investment, the

form of using foreign capital and continuously improved the level of cooperation with multinational companies. [2] To effectively attract foreign investment, the Chinese government has continuously relaxed the control on M&A of multinational enterprises. Moreover, it issued a series of laws and regulations conducive to foreign investment participation in the restructuring and transformation of state-owned enterprises, thus improving the legal environment for mergers and acquisitions of multinational companies in China. With the improvement of China's application to international tax treaties, multinational corporations that are not a party to tax treaties use the tax treaties to sign. More and more people in China set up intermediary companies to obtain tax incentives for tax avoidance. At the same time, to achieve the purpose of tax avoidance, some multinational companies will make use of the tax rules of other countries to achieve double non-tax residents and bypass the jurisdiction of the country.

"Double Irish with a Dutch Sandwich", the tax avoidance method which was first created by Apple and then was copied by thousands of multinational enterprises including Google, has been put in the spotlight. Apple company, as one of the noted multinational enterprises, has its method to avoid taxes. Apple uses one main step to realize its tax avoidance, which is utilizing the differences between the tax law of Ireland and the tax law of the United States in the identification standards of tax resident status. [10] The United States has a relatively complete system of anti-tax avoidance. In theory, the tax authorities can be used to Pierce the company veil system to exercise the right of tax. However, due to the system of the judicial system in the United States, applying to the premise of the system is more. From the court in a tax case history, our tax authorities had very little success, so comprehensive consideration to the reasons of litigation costs, The US tax authorities chose not to Sue.

China's current tax supervision system is not perfect and lacks a system with modern technology characteristics. There is no effective tax management system for the overseas assets and assets of multinational companies. An imperfect system could damage China's tax base by preventing regulators from identifying some of the more complex and hidden tax avoidance methods of multinational enterprises. [4]

In the process of the government's anti-tax avoidance supervision, in addition to a sound legal system, a good monitoring system is also an important link to achieving the goal of anti-tax avoidance. For the reporting and disclosure of cross-border trade information, the system is an effective means of anti-tax avoidance. In the foreign supervision system of the United States, the Foreign Investment Committee has been established to evaluate and review cross-border mergers and acquisitions in important industries during the market access stage. Founding a multi-agency collaboration system is an effective link to help tax authorities effectively connect.

3.1.2 China's anti-tax avoidance system does not fully adapt to the international development situation

China's current tax rules have been difficult to adapt to the increasingly complex tax avoidance arrangements of multinational enterprises. Many problems in OECD's BEPS Action Plan issued in 2013, such as new challenges brought by the development of e-commerce and the matching of transfer pricing arrangements with value creation, are also reflected in China. Meanwhile, the "two-pillar" reform plan of OECD (also known as "BEPS 2.0") is gradually formed in 2022. Pillar 1 will redistribute the right to tax the global profits of large multinational corporations, and part of the excess profits transferred to tax havens or low-tax places will be redistributed to market countries according to certain standards. Pillar II ensures that the effective tax rate of large multinational corporations in any global tax jurisdiction is no lower than the global minimum tax rate through the implementation of the global minimum tax.

Even though China is not a member of the OECD at present, according to the statistics of the Ministry of Commerce of China, from January to February of 2022, the amount of foreign investment used in China was 243.7 billion CNY, with a year-on-year increase of 37.9%. It is a fact that most multinational enterprises in the high-tech industry in China are from OECD member countries. Therefore, understanding the OECD's latest international tax control system, combining it with China's actual national conditions, and the market conditions of foreign-invested enterprises can be

more effective for China's anti-tax avoidance system for multinational companies especially in regulating the situations such as corporate transfer pricing. [14]

3.1.3 The insufficient practical operation of the anti-tax avoidance system

In terms of tax avoidance by multinational enterprises, among the management measures introduced by China, there is no authoritative legal policy on international tax avoidance, and the work of tax authorities also lacks legal support. With the development of the digital economy, intangible assets such as patented technologies are gradually increasing in enterprises. At the same time, considering the needs of the high-tech field, the introduction of foreign-funded enterprises in China is increasing year by year. China is facing a new challenge, that is, how to protect its tax bases against the more complex and hidden taxation patterns of intangible assets.

Although the United States has a perfect anti-tax avoidance system, it still fails to completely block the tax avoidance path of multinational enterprises. [6] Many noted American companies including Apple and Microsoft, still use the tax avoidance methods mentioned above in this essay, such as transfer pricing of intangible assets, cost-sharing, and other methods to reduce tax. From the tax avoidance methods of such companies, the society can know the application of US tax law and the applicable boundary of bilateral tax agreements, thus inspiring the improvement of China's tax avoidance system. [10]

What is directly related to the actual operation process of China's anti-tax avoidance system is the fusion and conflict between the international vision and the domestic situation. [13] China's historical direction has changed in 2021, from the new normal to a new stage of development, the economic development model and policies will change. At the same time, the development trend of China's tax reform will change from efficiency priority to fairness priority. Therefore, regulating foreign investment tax preferences is a direction that China needs to consider at present. [7] China's anti-tax avoidance system, under the premise of focusing on the world, should create a more level playing field for international and domestic enterprises of all types. This is a change produced by China considering its situation. Such a change in concept also makes its anti-tax avoidance system lacks a reference object, and the perfection of its actual operation requires a step-by-step exploration to complete it.

3.2 The reasons for the current situation

First of all, from the perspective of the international environment, with the development of economic globalization especially after China enters the World Trade Organization, a large amount of foreign capital has entered the Chinese market, which has gradually complicated the distribution and coordination of interests in modern market competition. The most obvious form of taxation relationship is tax avoidance and anti-tax avoidance. From a practical point of view, it means that to maximize their interests, it is inevitable for multinational companies to conduct international tax avoidance. [8] However, for the Chinese industry in recent years, the significance of actively attracting foreign capital still exists. The Chinese industry is developing in the direction of a full-value high-end industrial chain. What foreign capital brings to the Chinese industry is not only capital investment, but also an increase in all aspects including management experience, scientific and technological level, market awareness. The entry of foreign capital into the Chinese market also enables the Chinese market to more quickly integrate with the international community, further enhancing the international competitiveness of Chinese industries. [7] According to the data from the Ministry of Commerce of China in 2021, the growth rate of the actual use of foreign capital in the whole year will reach 14.9%, and the proportion of foreign investment in high-tech industries will exceed 30% for the first time. However, in the process of attracting foreign investment, market risks inevitably arise. The most obvious manifestation is the anti-tax avoidance game between tax authorities and multinational companies.

There is a game of interest between China's tax authorities and multinational enterprises. In China's past management theories, tax avoidance and anti-tax avoidance between tax authorities and

multinational companies have shown an antagonistic struggle. The game is a non-cooperative game, which makes it more difficult for tax authorities to supervise anti-tax avoidance. [12]

Secondly, due to the lagging characteristics of the legal system and the increasing number of complex and hidden tax avoidance methods of multinational companies, the two are in a dynamic game. [11] The tax avoidance behavior of multinational companies appeared first, followed by the anti-tax avoidance control of tax authorities. In addition, due to the increased uncertainty of individual multinational companies' tax avoidance behaviors caused by non-cooperative games, the requirements for China's tax authorities' anti-tax avoidance system have increased. At the same time, there is still a game of information between the tax authorities and multinational companies. There is asymmetric information between the two. Multinational companies have far more information on the import and export prices of commodities and the price trend of the international market than the tax authorities. It will achieve the purpose of tax reduction and exemption to the greatest extent under its mastery of market information.

4. Optimization of anti-tax avoidance regulation

4.1 Improve the general anti-tax avoidance systems

A keyword in China's anti-tax avoidance is "whether it has a reasonable commercial purpose", and the definition of this point is not clear in the article. The ambiguity of the provisions will lead to disputes in practical operation and the inability to efficiently complete tax supervision. [5]

Therefore, this clause needs to be clarified so that tax personnel can operate in actual situations. Specifically, tax officials preliminarily determine whether the foreign-funded enterprise has a "commercial arrangement for reducing, exempting or delaying tax payment" based on the database information and its professional skills. Purpose. At the same time, it is very difficult to obtain public data when the tax authorities conduct a comparability analysis, which is also caused by the fact that China's legal provisions do not stipulate the content of financial reports disclosed by multinational companies. China should actively supplement legal provisions to limit the number of fees MNEs pay to their overseas affiliates, to prevent MNEs from achieving international tax avoidance through transfer pricing.

4.2 Further improve the supporting facilities for anti-tax avoidance

4.2.1 Optimization of manpower

Due to the professionalism and complexity of the international anti-tax avoidance field, the core team requires strong professional skills and comprehensive analysis capabilities, China's legislation on international anti-tax avoidance started relatively late which led to the tax authorities lacking information on international market conditions. As a result, the pool of anti-tax avoidance professionals is not enough, the staffing is insufficient in quantity and quality, the structure of anti-tax avoidance personnel is relatively simple. Meanwhile, there is a lack of high-quality anti-tax avoidance talents. At the same time, there is a lack of emphasis on anti-tax avoidance work in various regions. Many regions have not established special international anti-tax avoidance agencies, which makes the professional talents not fully utilized. [3]

China should speed up the informatization of tax collection, establish a sound multi-departmental information sharing mechanism, and form an external collaborative network for monitoring cross-border tax sources, simultaneously promoting the collaboration of multiple departments to ensure effective and strict supervision. Meanwhile, a sound talent training mechanism and assessment mechanism should be prepared. A complete talent pool should be built. During the actual review process, tax authorities should strengthen information exchange, popularize cutting-edge tax-related knowledge through case exchanges, and improve the professional skills of tax personnel. Through these methods, the authorities can discover the tax-related doubts in cross-border tax source management and apply for tax information requests. [4]

In practice, China should first improve the internal supervision system, establish a talent pool for anti-tax avoidance cases and a database of international tax avoidance cases, using traditional methods such as the comparable non-usable price method and the transactional net profit method for data analysis to save labor costs and promote standardization. Secondly, for the training of international anti-tax avoidance talents, special majors can be set up in universities. Domestic and foreign experts can be hired to give lectures, and international tax avoidance case analysis, professional knowledge, and domestic and foreign anti-tax avoidance methods can be systematically compiled and taught. Meanwhile, authorities should also improve the assessment, issue professional certificates, and improve the overall quality of anti-tax avoidance talents.

4.2.2 Optimization of material resources

China can choose to establish a cross-border transaction information reporting and disclosure system, and establish a more comprehensive reporting and registration system between multinational enterprises and their affiliated businesses. The substantive review of the contract is carried out for matters such as asset transfer and for projects where the contract reaches a certain amount. Based on improving the reporting system, authorities can design a professional database for cross-border tax source management, using digital analysis to analyze the risks, and plays a fundamental role when tax officials failed to find tax-related doubts in time. [4]

Facing the increasing frequency in the international market, such as cases related to pricing of intangible assets such as trading equity and royalties. Since the database cannot be compared to cases that closely match the situation, the traditional analysis method is impossible to directly judge whether its pricing is appropriate or not, more accurate economic and statistical analysis is required. For such cases, according to the handling methods of developed countries such as the United States, China can cooperate with a trustworthy accounting firm, and the firm's economist analysis team will analyze to determine whether multinational enterprises are involved in unreasonable tax avoidance.

4.3 Strengthen cooperation between countries and formulate more complete implementation rules based on China's national conditions

Considering the actual relationship between M&A and government regulation of multinational enterprises in China, using environmental regulation, quality regulation, economic system, and cross-border M&A as variables. According to the multivariate Granger causality test, the impact of economic regulation on cross-border M&A is Significant, while social regulation, such as environmental regulation and quality regulation, has no significant impact on cross-border M&A. Therefore, in terms of the implementation rules for anti-tax avoidance of Chinese multinational companies, it is necessary to comply with China's current economic development laws and regulatory restructuring rules, and timely adjust certain economic regulations on multinational enterprises in China. The company's shareholding ratio, production, supply, marketing, and human resources restrictions can prevent excessive regulation and offside, improve the scale and quality of investment, and avoid compromising the tax base. [3]

At the same time, the application of bilateral tax treaties should be cautious. [10] China's demand for foreign capital has led it to sign bilateral tax treaties with many countries, forming a huge network of bilateral tax treaties. However, there are certain loopholes in tax information due to the differences in multi-country systems. To avoid some multinational enterprises using loopholes to achieve tax avoidance purposes, from a practical point of view, China should first strengthen the degree of information exchange with other countries, conducting regular international tax avoidance exchange meetings with countries that have signed bilateral tax treaties. The tax authorities could record and archive changes in the tax systems of multiple countries and regularly compare the differences in tax systems between countries to avoid tax avoidance methods such as transfer pricing by multinational companies. Secondly, with complete information, China can strengthen international tax supervision and cooperation with other countries, sign mutual assistance agreements. Due to these measures, authorities can legally realize a mutual assistance system for tax collection and management, and also regulate those unreasonable cross-border tax avoidance methods. China should take precautionary

measures against possible consequences arising from the application of bilateral agreements. On the other hand, tax governance cooperation and tax information exchange with countries that sign the agreement is a must.

5. Conclusion

During the process of the growing economy and the acceleration of globalization in China, the flow of international capital has accelerated. In order to adapt to the development of the international community, China's actual demand for foreign investment is large. To attract foreign investment, the standard is relaxed and this behavior requires a relatively complete control system to ensure that China's tax revenue will not be lost due to various tax avoidance methods. The main reason for optimizing China's anti-tax avoidance system for multinational companies' supervision system is that China's anti-tax avoidance system does not match the international development trend, and the corresponding system supporting facilities are lacking. The lack of supporting facilities leads to insufficient practical operability of the system. Given the imperfect aspects of these systems, the main solution discussed in this essay is first to clarify the content of some provisions of China's general anti-tax avoidance laws and regulations. Secondly, improving the human and material resources of the system supporting facilities. While the last step is to strengthen the International anti-tax avoidance cooperation.

With the continuous improvement of China's internationalization, the ability and the demand to attract foreign investment is increasing. Considering the complexity and concealment of the tax avoidance methods of multinational enterprises, China needs to continuously improve its anti-tax avoidance capabilities, optimization of legal provisions and supervision capabilities. Therefore, this essay proposes to improve the anti-tax avoidance supervision system from the perspectives of written legal clauses, international agreements, supporting equipment and human resources responsible for the actual operation. Due to my lack of experience and limitations in research, I hope that some of the views in this paper can be of reference value to domestic scholars, which will help China's international anti-tax avoidance optimization.

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