

“Strangers in a Strange Land”: Chinese Companies in the American Tax System

Ji Li*

Foreign direct investment (“FDI”) from emerging economies generally exhibits two distinct characteristics: (1) most of the investors thrive in poor regulatory environments, and (2) the visible hand of the state exerts a powerful influence. Due to these two features, emerging market FDI poses novel questions to tax law scholars and U.S. policymakers. For instance, will the investors import noncompliance practices? Or will they adapt to the complex and stringent regulatory regime of the host country? To answer these questions, this Article presents the first empirical study of Chinese multinational companies operating in the U.S. tax system. Despite wide gaps between the two countries in terms of tax administration and compliance, Chinese investors in the United States generally appear to have adapted to U.S. tax law. In terms of tax audits and disputes with the Internal Revenue Service (“IRS”), this study finds preliminary evidence that distinguishes between the investments of state-owned companies and those of privately owned companies. Overall, the findings contribute to several important policy and theoretical debates and have significant, practical implications.

* Associate Professor, Rutgers Law School; J.D., Yale Law School; Ph.D., Northwestern University; email: jli@kinoy.rutgers.edu. For valuable comments, I would like to thank Cynthia Blum, Thomas Brennan, Dhammika Dharmapala, Alan Hyde, Stuart Deutsch, John Leubsdorf, Omri Marian, David Noll, Mark Ramseyer, Fadi Shaheen, Stephen Shay, and Yan Xu, as well as several other participants at the 27th Annual Meeting for the American Law and Economics Association and the Faculty Colloquium at Rutgers Law School.

TABLE OF CONTENTS

INTRODUCTION.....	504
I. FOREIGN DIRECT INVESTMENT AND TAXATION.....	506
II. A COMPARATIVE INTRODUCTION TO THE CHINESE TAX REGIME.....	509
III. AN EMPIRICAL STUDY OF CHINESE COMPANIES IN THE U.S. TAX SYSTEM.....	514
A. DESCRIPTION OF CHINESE COMPANIES IN THE U.S. TAX SYSTEM.....	517
1. <i>Perception of the U.S. Tax Burden</i>	517
2. <i>Perception of the U.S. Tax Law</i>	518
3. <i>Handling U.S. Tax Matters</i>	520
4. <i>Tax Audits and Disputes with the IRS</i>	521
5. <i>Tax Avoidance</i>	523
B. REGRESSION ANALYSIS OF THE EFFECT OF CHINESE GOVERNMENT OWNERSHIP.....	526
1. <i>Tax Audits and Disputes with the IRS</i>	526
2. <i>Tax Planning to Avoid U.S. Tax</i>	533
IV. CONTRIBUTIONS AND LIMITATIONS OF THIS STUDY.....	538
CONCLUSION.....	539

INTRODUCTION

Despite the global financial crisis, the world economy continues to integrate, and much of the integration takes the form of cross-border capital flows.¹ As a major driving force behind the capital flows, foreign direct investments (“FDI”) by multinational corporations have generated numerous debates and controversies. Of the many FDI-related debates, those concerning the taxation of multinational corporations have probably garnered the most attention from practitioners, scholars, and policymakers.

A vast literature has emerged that covers a broad range of tax issues such as the fiscal effect of tax avoidance by the corporations on state-sponsored welfare,² the corporate response to tax inducement,³ and the level

1. Helen V. Milner, *The Global Economy, FDI, and the Regime for Investment*, 66 *WORLD POL. (SYMPOSIUM ISSUE)* 1, 1 (2014).

2. See, e.g., Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 *HARV. L. REV.* 1573, 1579 (2000).

3. See generally Sebastian Krauthaim & Tim Schmidt-Eisenlohr, *Heterogeneous Firms, ‘Profit Shifting’ FDI and International Tax Competition*, 95 *J. PUB. ECON.* 122 (2011) (analyzing tax competition in a large country versus a tax haven); Mihir A. Desai et al., *Foreign Direct Investment in a World of Multiple Taxes*, 88 *J. PUB. ECON.* 2727 (2004) (examining the impact of American multinational firms indirect taxes on FDI);

of international cooperation in tax policymaking and implementation.⁴ Despite the broad thematic coverage, the resulting literature has focused on multinational companies headquartered in developed countries and offers few insights about soaring outbound investment from developing countries.⁵ Marking a profound shift in the global economic order, the recent reverse flow of FDI exhibits two distinct features: (1) most of the investors have been thriving in poor regulatory environments;⁶ and (2) the “visible hand” of the state exerts a powerful influence,⁷ either directly through laws and policies or indirectly through the operation of state-owned enterprises (“SOE”).⁸ The two distinct features pose novel and important tax law and policy questions that the existing literature has failed to address.

To present some preliminary answers, this Article empirically investigates how large Chinese-invested companies in the United States respond to the U.S. tax system. The investigation intentionally focuses on Chinese firms in the United States for three reasons. First, despite the ebb of investment from other countries, Chinese multinationals continue to invest heavily abroad and account for a large share of outward FDI from developing countries.⁹ As a matter of fact, outward FDI from China exceeds the combined investment outflows from all the other major emerging markets.¹⁰ Second, China-based multinationals, having survived and prospered in the Chinese regulatory environment, should face daunting compliance challenges in the United States. Of all the challenges, their need to comply with the U.S. tax law clearly stands out as the most demanding. Thus, a study of how large Chinese companies react to the complex law-based U.S. tax system elucidates how they will

Nathan M. Jensen, *Fiscal Policy and the Firm: Do Low Corporate Tax Rates Attract Multinational Corporations?*, 45 COMP. POL. STUD. 1004 (2012) (discussing corporate responses to tax inducement).

4. See Kimberly A. Clausing, *Multinational Firm Tax Avoidance and Tax Policy*, 62 NAT'L TAX J. 703, 720 (2009); Michael Plowgian, *BEPS: The Shifting International Tax Landscape and What Companies Should Be Doing Now*, 65 TAX EXECUTIVE 255, 255 (2013).

5. According to the most recent report on global FDI, “Nine of the 20 largest investor countries were from developing or transition economies.” United Nations Conference on Trade & Development, *World Investment Report 2015: Reforming International Investment Governance*, p. ix [hereinafter *World Investment Report 2015*].

6. Samuel Adomako & Albert Danso, *Regulatory Environment, Environmental Dynamism, Political Ties, and Performance: Study of Entrepreneurial Firms in a Developing Economy*, 21 J. SMALL BUS. & ENTERPRISE DEV. 212, 214 (2014).

7. See generally Anne S. Tsui et al., *Organization and Management in the Midst of Societal Transformation: The People's Republic of China*, 15 ORG. SCI. 133 (2004); Benjamin L. Liebman & Curtis J. Milhaupt, *Introduction to REGULATING THE VISIBLE HAND?: THE INSTITUTIONAL IMPLICATIONS OF CHINESE STATE CAPITALISM* xiii (Benjamin L. Liebman & Curtis J. Milhaupt eds., 2015) (discussing the “visible hand” of states who exert powerful influence).

8. For instance, investment by Chinese state-owned enterprises accounted for approximately eighty percent of Chinese cumulative investment stock. Ping Deng, *Chinese Outward Direct Investment Research: Theoretical Integration and Recommendations*, 9 MGMT. & ORG. REV. 513, 518 (2013).

9. WORLD INVESTMENT REPORT 2015, *supra* note 5, at 8–10.

10. *Id.*

adapt to the legal and regulatory institutions of all developed countries. Third, because SOEs play a prominent role in Chinese outward FDI, this study also illuminates the effect of government ownership on the response of emerging market investors to the host country's legal and regulatory environment.

In addition, an empirical study of legal and regulatory compliance by investors from the largest *developing* country in the world in the largest *developed* country implies much as both countries go forward. On a practical level, U.S. tax professionals would want to learn how Chinese investors cope with the U.S. tax system as would tax agencies at both the federal and state level. Moreover, this study contributes to an informed debate about the costs and benefits, especially the long-term fiscal benefits, of rapidly growing investments from China.

This Article has two points of focus. First, it presents an empirical description of how sizable Chinese companies cope with the complex law-based U.S. tax system. Second, it presents my findings on the effect of Chinese government ownership in two areas central to tax compliance: (1) tax audits and disputes with the IRS; (2) and tax planning to avoid U.S. taxes. The Article proceeds as follows: Part I briefly reviews the literature on FDI and taxation and discusses Chinese investment in the United States and its potential implications. Part II, by way of a comparative introduction of the Chinese tax system, highlights the challenges Chinese investors may face while operating under the U.S. tax laws. Part III begins with a brief description of the original data drawn from a comprehensive survey of large Chinese companies in the United States. It then provides an empirical overview of various characteristics that are pertinent to these companies' tax compliance and statistically analyze the effects of state ownership. Part IV summarizes the contributions and limitations of this study. A brief conclusion follows.

I. FOREIGN DIRECT INVESTMENT AND TAXATION

The literature on FDI and taxation revolves around three major topics. First and foremost, most of the scholarship concentrates on the connections between tax rates and the flow of investment. Some find changing tax rates significantly impact the amount of FDI.¹¹ At a more detailed level, corporate tax liability is prominently featured in business

11. See generally Deborah L. Swenson, *The Impact of U.S. Tax Reform on Foreign Direct Investment in the United States*, 54 J. PUB. ECON. 243 (1994); Michael L. Moore et al., *An Analysis of the Impact of State Income Tax Rates and Bases on Foreign Investment*, 62 ACCT. REV. 671, 671-85 (1987); Michael P. Devereux & Harold Freeman, *The Impact of Tax on Foreign Direct Investment: Empirical Evidence and the Implications for Tax Integration Schemes*, 2 INT'L. TAX PUB. FIN. 85, 85-106 (1995); Christian Bellak & Markus Leibrecht, *Do Low Corporate Income Tax Rates Attract FDI?—Evidence from Central- and East European Countries*, 41 APPLIED ECON. 2691, 2691-703 (2009) (examining the relationship between rates and flow of investment and how this relationship impacts FDI).

decisions such as allocation of revenue and expense, direction of capital flow, and location of investment.¹² Most governments, aware of the correlation between tax rates and FDI, engage in a competitive reduction, voluntarily or not, of corporate tax.¹³ This race to the bottom spurs a major debate on policy reactions and their consequences.¹⁴ Though some sound the alarm of fiscal crisis in welfare countries,¹⁵ others praise the “tax havens” for contributing to efficiency in global capital allocation or enhancing the welfare of high tax countries.¹⁶

However, when researchers bring developing countries into the picture the strong and linear correlation between low tax rates and high FDI weakens. For instance, only middle income developing countries are found to benefit from bilateral tax treaties,¹⁷ and for the tax inducements to work, a primary condition is good governance.¹⁸ Similarly, when governments of transitional states make tax concessions, they fail to attract FDI.¹⁹ A plethora of research explores such signs of causal nonlinearity along with the institutional and structural factors that affect tax incentives designed to attract FDI.²⁰ Moreover, to supplement the findings from the cross-country econometric research, in-depth studies have been undertaken to explore the relationship between tax incentives and FDI in individual developing countries.²¹

12. See generally Agnès Bénassy-Quéré et al., *How Does FDI React to Corporate Taxation?*, 12 INT'L TAX & PUB. FIN. 583 (2005); John Mutti & Harry Grubert, *Empirical Asymmetries in Foreign Direct Investment and Taxation*, 62 J. INT'L ECON. 337 (2004); Steven P. Cassou, *The Link Between Tax Rates and Foreign Direct Investment*, 29 APPLIED ECON. 1295 (1997); Buettner & Ruf, *supra* note 3.

13. See generally Michael P. Devereux et al., *Do Countries Compete over Corporate Tax Rates?*, 92 J. PUB. ECON. 1210 (2008); Céline Azémar & Andrew Delios, *Tax Competition and FDI: The Special Case of Developing Countries*, 22 J. JAP. & INT'L ECONOMIES 85 (2008) (discussing governments' reduction of corporate tax to encourage FDI).

14. See generally Victor M. Gastanaga et al., *Host Country Reforms and FDI Inflows: How Much Difference Do They Make?*, 26 WORLD DEV. 1299 (1998); David G. Hartman, *Tax Policy and Foreign Direct Investment in the United States*, 37 NAT'L TAX J. 475 (1984); James R. Hines, Jr., *Lessons from Behavioral Responses to International Taxation*, 52 NAT'L TAX J. 305 (1999) (discussing the benefits and consequences of reduced corporate taxes).

15. Avi-Yonah, *supra* note 2, at 1573.

16. Qing Hong & Michael Smart, *In Praise of Tax Havens: International Tax Planning and Foreign Direct Investment*, 54 EUR. ECON. REV. 82, 84 (2010).

17. Eric Neumayer, *Do Double Taxation Treaties Increase Foreign Direct Investment to Developing Countries?*, 43 J. DEV. STUD. 1501, 1518–19 (2007).

18. Dhammika Dharmapala & James R. Hines Jr., *Which Countries Become Tax Havens?*, 93 J. PUB. ECON. 1058, 1065–66 (2009).

19. J. Beyer, “Please Invest in Our Country”—How Successful Were the Tax Incentives for Foreign Investment in Transition Countries?, 35 COMMUNIST & POST-COMMUNIST STUD. 191, 208 (2002).

20. See, e.g., Quan Li, *Democracy, Autocracy, and Tax Incentives to Foreign Direct Investors: A Cross-National Analysis*, 68 J. POL. 62, 69–71 (2006); Jensen, *supra* note 3, at 1019–20.

21. See, e.g., Samuel Tung & Stella Cho, *The Impact of Tax Incentives on Foreign Direct Investment in China*, 9 J. INT'L ACCT. AUDITING & TAX'N 105, 106–08 (2000); Samuel Tung & Stella Cho, *Determinants of Regional Investment Decisions in China: An Econometric Model of Tax Incentive Policy*, 17 REV. QUANTITATIVE FIN. & ACCT. 167, 168 (2001).

Despite the soaring attention to developing countries, the existing literature fails to address the two major questions pertinent to the new wave of emerging market FDI flowing into developed countries. One, having focused narrowly on the “tax rate”-“investment” relationship, very few scholars have systematically examined how investors from developing countries react to a complex and law-based tax system in their host developed countries.²² Two, the current research lacks any empirical study concerning tax compliance by SOEs investing and operating in developed countries.

To broaden the scope of inquiry and fill the gaps in the literature, this Article examines how Chinese-invested companies interact with the U.S. tax system. It also investigates the effects of state ownership in two areas central to an investor’s tax compliance in the United States: (1) audits and disputes with the IRS; and (2) tax planning. Before proceeding to the empirical analysis, a succinct overview of Chinese FDI into the United States would help contextualize the analysis.

After decades of fast growth, China has transformed from a poverty plagued third world country into a middle income economy second in size only to the United States.²³ Meanwhile, Chinese outward FDI rose from the relatively trivial amount of \$830 million in 1990 to \$101 billion in 2013.²⁴ Chinese FDI in the United States follows the same trajectory (see FIGURE 1).²⁵ As a result of explosive growth, the United States has recently emerged as the largest national recipient of Chinese FDI.²⁶ Due to its scale and potential ramifications, China’s outward FDI has spawned a growing literature on a wide range of topics.²⁷ Yet so far only a very few scholars

22. Recent empirical research on norms and compliance uncovered evidence that foreign institutions such as corrupt social norms exert significant influence on foreign persons’ compliance behavior in the United States. Raymond Fisman & Edward Miguel, *Corruption, Norms, and Legal Enforcement: Evidence from Diplomatic Parking Tickets*, 115 J. POL. ECON. 1020, 1022 (2007). Another empirical study uncovers a connection between tax noncompliance and U.S. companies controlled by foreign investors based in corrupt societies. Jason DeBacker et al., *Importing Corruption Culture from Overseas: Evidence from Corporate Tax Evasion in the United States*, 117 J. FIN. ECON. 122, 123–24 (2015).

23. Ji Li, *I Came, I Saw, I... Adapted: An Empirical Study of Chinese Business Expansion in the United States and Its Legal and Policy Implications*, 36 Nw. J. INT’L L. & BUS. 143, 147 (2016).

24. Karl Sauvant, Opinion, *Challenges for China’s Outward FDI*, CHINA DAILY USA (Oct. 31, 2013, 7:10 AM), http://usa.chinadaily.com.cn/opinion/2013-10/31/content_17070440.htm.

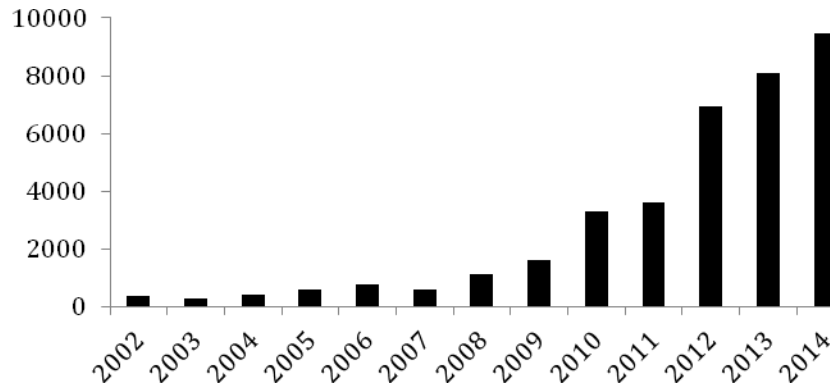
25. ECONOMIST INTELLIGENCE UNIT, CHINA GOING GLOBAL INVESTMENT INDEX 2 (2013).

26. Derek Scissors, *A Third Straight Record for Chinese Investment in the US*, AM. ENTERPRISE INST. (Jan. 12, 2015), <http://www.aei.org/publication/third-straight-record-chinese-investment-us/>.

27. See, e.g., Syed Tariq Anwar, *FDI Regimes, Investment Screening Process, and Institutional Frameworks: China Versus Others in Global Business*, 46 J. WORLD TRADE 213 (2012); Diego Quer et al., *Political Risk, Cultural Distance, and Outward Foreign Direct Investment: Empirical Evidence from Large Chinese Firms*, 29 ASIA PAC. J. MGMT. 1089 (2012); Jun Xia et al., *Outward Foreign Direct Investment by Emerging Market Firms: A Resource Dependence Logic*, 35 STRATEGIC MGMT. J. 1343 (2014); ANDREW SZAMOSSZEGI, AN ANALYSIS OF CHINESE INVESTMENTS IN THE U.S. ECONOMY I (2012); Mike W. Peng, *The Global Strategy of Emerging Multinationals from China*, 2 GLOBAL STRATEGY J. 97 (2012); Bala Ramasamy et al., *China’s Outward Foreign Direct Investment: Location Choice and Firm Ownership*, 47 J. WORLD BUS. 17 (2012); Chengqi Wang et al., *What Drives Outward FDI of Chinese Firms? Testing the Explanatory Power of*

have examined Chinese investments in developed countries.²⁸ This is the case simply because most multinational corporations from emerging countries only recently began to venture into more mature and competitive markets.²⁹

FIGURE 1: CHINESE FDI IN THE UNITED STATES IN MILLIONS OF U.S. DOLLARS (2002–2014)³⁰



To summarize, the vast literature on FDI and taxation neglects multinational corporations based in developing countries, and the growing literature on Chinese outbound FDI has not yet filled the gap as it barely covers Chinese investors in developed countries. This Article begins to fill the void by empirically exploring China-based multinational corporations in the U.S. tax system.

II. A COMPARATIVE INTRODUCTION TO THE CHINESE TAX REGIME

This Part presents some basic background knowledge about the Chinese tax system in comparison to the U.S. system and highlights the differences between the two. In China, the government currently imposes eighteen categories of tax,³¹ most of which also serve as major sources of

Three Theoretical Frameworks, 21 INT'L BUS. REV. 425 (2012); Ivar Kolstad & Arne Wiig, *What Determines Chinese Outward FDI?*, 47 J. WORLD BUS. 26 (2012); THEODORE H. MORAN & LINDSAY OLDENSKI, FOREIGN DIRECT INVESTMENT IN THE UNITED STATES: BENEFITS, SUSPICIONS, AND RISKS WITH SPECIAL ATTENTION TO FDI FROM CHINA (2013).

28. There are only very few exceptions. See, e.g., Andreas Klosssek et al., *Chinese Enterprises in Germany: Establishment Modes and Strategies to Mitigate the Liability of Foreignness*, 47 J. WORLD BUS. 35 (2012); Li, *supra* note 23.

29. Wladimir Andreff & Giovanni Balcer, *Emerging Countries' Multinational Companies Investing in Developed Countries: At Odds with the HOS Paradigm?*, 10 EUR. J. COMP. ECON. 3, 3 (2013).

30. *Foreign Direct Investment in the U.S.: Balance of Payments and Direct Investment Position Data*, BUREAU OF ECON. ANALYSIS, <https://www.bea.gov/international/dirfdibal.htm> (last visited Mar. 11, 2017).

31. *China Tax System*, STATE ADMIN. OF TAX'N OF THE PEOPLE'S REPUBLIC OF CHINA (Nov. 25, 2016), <http://www.chinatax.gov.cn/eng/n2367731/index.html>. The eighteen taxes include: (1) corporate income tax,

revenue in the United States, such as corporate income tax and individual income tax. The value-added tax (“VAT”) is a major distinction between the two systems. Absent in the United States, the VAT accounts for more revenue than any other tax in China’s government coffers.³²

Some differences are also apparent in tax administration. While the U.S. government relies heavily on voluntary compliance for income reporting and tax collection,³³ China depends on a system that is better characterized as labor intensive. Chinese tax bureaus at all levels employ about 755,000 full-time agents, roughly half of whom work for local and regional governments.³⁴ While tax administration in the United States reflects its federalist political regime, where state and local tax agencies function largely independently from the IRS, China follows a hierarchical dual structure for tax administration. The State Administration of Taxation (“SAT”) in Beijing leads offices of the State Tax Bureau (“STB”) at the provincial, municipal and district, and county level, in order of decreasing rank.³⁵ Each provincial government also controls a regional tax administration agency, such as the Local Tax Bureau (“LTB”), which is subject to the dual leaderships of the SAT and the provincial government.³⁶

The Chinese tax agencies formally derive their administrative authority from the People’s Republic of China (“P.R.C.”) Law on the Administration of Tax Collection³⁷ as well as other substantive laws such as the P.R.C. Law on Individual Income Tax and the P.R.C. Law on Enterprise Income Tax.³⁸ Moreover, the SAT and the Ministry of Finance (the Chinese equivalent of the U.S. Treasury Department) possess extensive legislative power.³⁹ Lawful or not, lower tax agencies also issue rules that Chinese taxpayers generally obey.⁴⁰

(2) individual income tax, (3) value added tax, (4) business tax, (5) consumption tax, (6) land appreciation tax, (7) real estate tax, (8) arable land occupation tax, (9) urban land-use tax, (10) stamp tax, (11) custom duties, (12) deed tax, (13) vehicle acquisition tax, (14) vehicle and vessel tax, (15) resource tax, (16) urban construction and maintenance tax, (17) vessel tonnage tax, and (18) tobacco tax. *Id.*

32. Ji Li, *Dare You Sue the Tax Collector? An Empirical Study of Administrative Lawsuits Against Tax Agencies in China*, 23 PAC. RIM L. & POL’Y J. 57, 61 (2014).

33. J. T. Manhire, *There Is No Spoon: Reconsidering the Tax Compliance Puzzle*, 17 FLA. TAX REV. 623, 630 (2015).

34. 税务干部队伍建设 [hereinafter *Construction of Tax Cadres Team*], STATE ADMIN. OF TAX’N, <http://www.chinatax.gov.cn/n810351/n810901/n848227/c1161565/content.html> (last visited Mar. 11, 2017); Li, *supra* note 32, at 71.

35. *Construction of Tax Cadres Team*, *supra* note 34; Li, *supra* note 32, at 71.

36. *Construction of Tax Cadres Team*, *supra* note 34.

37. *Law of the People’s Republic of China on Tax Collection and Administration* [hereinafter *Tax Law of the P.R.C.*], art. 1, 2, ch. 1, CENT. PEOPLE’S GOV’T OF THE PEOPLE’S REPUBLIC OF CHINA (Aug. 31, 2005), http://www.gov.cn/banshi/2005-08/31/content_146791.htm.

38. 税收制度的法律级次 [The Legal Level of the Tax System], STATE ADMIN. OF TAX’N, <http://www.chinatax.gov.cn/n810351/n810901/n848188/c1161500/content.html> (last visited Mar. 11, 2017).

39. Li, *supra* note 32, at 64.

40. *Id.*

Except for matters relating to the VAT, formal tax administration and compliance procedures in China and the United States share some common features. Taxpayers in both countries register with relevant tax bureaus, periodically report certain information required by the law, and pay taxes or receive refunds on a regular basis. Law governs all of these procedures; and formal institutions exist to protect taxpayers' legal rights. Similar to the U.S. administrative appeal mechanism, Chinese taxpayers have the legal right to challenge tax agency actions via a petition for reconsideration by a designated body in the tax bureau.⁴¹ In contrast to the appeal procedure with the IRS, however, Chinese taxpayers usually have to pay the assessed tax before filing a petition.⁴² Once the Chinese taxpayers have exhausted the administrative recourse, they may turn to the court.⁴³ Unlike in the United States, Chinese tax agencies typically bear the burden of proof to demonstrate that the disputed administrative acts are lawful.⁴⁴ Within three months of docketing a tax-related administrative case, the trial court in China is generally required by law to render a decision.⁴⁵ Any unsatisfied parties may then appeal to a higher court.⁴⁶

This brief comparative description of the Chinese tax regime probably accentuates its formal resemblance, in several respects, to the U.S. tax system. In some respects, such as the burden of proof generally imposed on tax agencies in administrative lawsuits, the Chinese government protects taxpayer rights more vigorously through the formal laws than does the United States. However, the caveat is the gap between the Chinese laws on the paper and the laws in practice.⁴⁷ In theory, Chinese tax agencies may administer revenue collection strictly in accordance with the law. And in terms of compliance, Chinese taxpayers, if they so intend, may act in ways akin to their U.S. counterparts. In

41. The bureau of the next higher level handles petitions against bureaus of the State Tax Bureau ("STB"). Petitions against an office of the Local Tax Bureau ("LTB") may be filed with either the corresponding local government or the bureau of a higher rank, unless otherwise stipulated by regional rules. Petitions against the STB in Beijing may be filed with the bureau itself. Petitions should in general be filed orally or in writing within sixty days after knowledge of the concrete administrative action. See *税务行政复议规则* [Rules of Tax Administrative Reconsideration], STATE ADMIN. OF TAX'N (Apr. 1, 2010), <http://www.chinatax.gov.cn/n810341/n810765/n812161/n812579/c1086133/content.html>.

42. *Tax Law of the P.R.C.*, *supra* note 37, art. 88. (promulgated by Decree No. 362 of the State Council of the People's Rep. of China, Sept. 7, 2002, effective Oct. 15, 2002).

43. *Id.*

44. *行政诉讼法* [Administrative Procedure Law], art. 34, SUPREME PEOPLE'S PROCURATORATE OF THE PEOPLE'S REPUBLIC OF CHINA (Feb. 17, 2015), http://www.spp.gov.cn/sscx/201502/t20150217_91466.shtml. In the case of the United States, the burden of proof may under certain limited conditions shift from the taxpayers to the IRS. See more details in the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 26 U.S.C. § 7491 (1999).

45. *Id.* art. 57.

46. *Id.* art. 80.

47. Ji Li, *Does Law Matter in China? An Empirical Study of a Limiting Case*, 46 GEO. WASH. INT'L L. REV. 119, 119-20 (2013).

practice, however, the taxpayers' power status relative to the tax agency dictates the terms of compliance and the actual administration of taxes.⁴⁸

For instance, some Chinese taxpayers, such as senior managers of SOEs, hold official status in the state apparatus⁴⁹ and therefore enjoy enormous policymaking power as well as power to negotiate favorable tax treatments.⁵⁰ The elevated power status of the managers shapes the SOEs' tax compliance and precludes tax controversies. If tax disputes ever occur, the powerful taxpayers and relevant tax agencies resolve them via channels within the state apparatus—few of these exceptional taxpayers ever adjudicate.⁵¹ Of course, due to the high cost of political bargaining, accountants for the SOEs deal with routine tax matters in accordance with rules and conventional practices. And according to prior studies in other legal areas, Chinese SOEs exhibit better compliance with law than do companies of other ownership structures.⁵² Thus, the political model described above best illustrates tax compliance in situations involving legal ambiguity or high stakes.

In comparison, small and medium-sized private Chinese companies that do not have much power rely heavily on personal connections with tax agents for tax compliance.⁵³ Deviation from the formal tax law is so widespread that “all the companies would be found in violation of the tax law if the government seriously investigates.”⁵⁴ When tax disputes arise, these taxpayers refrain from formal resolution—for example, administrative appeals or administrative litigation—and strive to settle.⁵⁵ Small and medium-sized private businesses only sue tax agencies in China in end game situations.⁵⁶

Because of the high stakes, large, private Chinese companies and multinationals put more reliance on formal law. The enormous cost of building protective personal connections on a national scale and their

48. The variation in regulatory compliance has been studied in more detail in non-tax areas such as labor and employment. *See, e.g.*, SEAN COONEY ET AL., *LAW AND FAIR WORK IN CHINA* (2013).

49. Ji Li, *State-Owned Enterprises in the Current Regime of Investor-State Arbitration*, in *THE ROLE OF THE STATE IN INVESTOR-STATE ARBITRATION* 380 (Shaheza Lalani & Rodrigo Polanco Lazo eds., 2014).

50. Wei Cui, *Taxation of State-Owned Enterprises: A Review of Empirical Evidence from China*, in *REGULATING THE VISIBLE HAND? THE INSTITUTIONAL IMPLICATIONS OF CHINESE STATE CAPITALISM*, *supra* note 7, at 109; Zhiyong An, *Taxation and Foreign Direct Investment (FDI): Empirical Evidence from a Quasi-Experiment in China*, 19 *INT'L TAX & PUB. FIN.* 660, 662 (2011). Some, however, argue that SOEs pay more taxes in China. *See* Oliver Zhen Li et al., *Controlling Shareholders' Incentive and Corporate Tax Avoidance—A Natural Experiment in China* (Feb. 26, 2014), <http://ssrn.com/abstract=2401619>.

51. Li, *supra* note 32, at 58.

52. *See, e.g.*, BOY LÜTHJE ET AL., *BEYOND THE IRON RICE BOWL: REGIMES OF PRODUCTION AND INDUSTRIAL RELATIONS IN CHINA* (2013).

53. *See, e.g.*, Katherine R. Xin & Jone L. Pearce, *Guanxi: Connections as Substitutes for Formal Institutional Support*, 39 *ACAD. MGMT. J.* 1641, 1641–42 (1996).

54. 地方政府逼企业而逃：协商税制趋紧补贴摸不着 [Local Governments Do Business], *FINANCE.QQ.COM* (Aug. 27, 2012, 11:07 AM), <http://finance.qq.com/a/20120827/003373.htm>.

55. Li, *supra* note 32, at 68–69.

56. *Id.*

lack of formal political status prevents them from taking advantage of the special treatment enjoyed by large Chinese SOEs. Though these large private companies may possess some de facto power over government policies, the lack of a common identity vitiates their ability to act collectively.⁵⁷ Without substantial political power, large private companies and multinational companies in China usually invest more to comply with formal tax regulations and agency rules. Compared to the other two groups (the SOEs and the small and medium-sized private companies), the large companies' behavior better resembles typical corporate tax compliance in the United States.

It merits emphasis that the three Chinese models of tax compliance are not mutually exclusive, as most sizable corporate taxpayers in China take multiple measures to mitigate their compliance risk. For instance, despite their formal political status, SOEs nonetheless spend on entertaining government officials to maintain cooperative personal relationships.⁵⁸ And private Chinese companies, while investing heavily in building good connections with government officials, eagerly seek official memberships in the ruling party or other formal political organizations.⁵⁹ Multinational companies, though more inclined to play by the formal rules, also cultivate good relationships with officials to mitigate the cost of institutional deficiencies in the transitional market.⁶⁰ Yet despite the overlap, the three stylized models capture the core features of tax compliance in China by taxpayers holding different power status.

While certain aspects of tax administration and compliance in the United States also fit these stylized nonlegal models—such as the substantial tax benefits due to lobbying by U.S. corporations⁶¹—what sets the two countries far apart is the role of the judiciary. In China, tax agencies are almost always the ultimate decisionmaker in cases of ambiguities and controversies;⁶² and Chinese taxpayers rarely litigate against tax agencies.⁶³ In the United States, by contrast, taxpayers commonly sue the IRS over tax matters.⁶⁴ The U.S. Tax Court, independent of the IRS, plays an essential

57. Kellee S. Tsai, *Capitalists Without a Class: Political Diversity Among Private Entrepreneurs in China*, 38 COMP. POL. STUD. 1130, 1150 (2005).

58. See, e.g., Hongbin Cai et al., *Eat, Drink, Firms, Government: An Investigation of Corruption from the Entertainment and Travel Costs of Chinese Firms*, 54 J.L. & ECON. 55, 57 (2011) (finding no significant variation in travel and entertainment costs incurred by Chinese firms of different ownership structures).

59. Hongbin Li et al., *Political Connections, Financing and Firm Performance: Evidence from Chinese Private Firms*, 87 J. DEV. ECON. 283, 296 (2008).

60. See, e.g., Mike W. Peng & Yadong Luo, *Managerial Ties and Firm Performance in a Transition Economy: The Nature of a Micro-Macro Link*, 43 ACAD. MGMT. J. 486 (2000); John A. Pearce II & Richard B. Robinson, Jr., *Cultivating Guanxi as a Foreign Investor Strategy*, 43 BUS. HORIZONS 31, 31–32 (2000).

61. Brian Kelleher Richter et al., *Lobbying and Taxes*, 53 AM. J. POL. SCI. 893, 906 (2009).

62. Li, *supra* note 32, at 68–69.

63. *Id.*

64. *Id.* at 57.

part in resolving disputes and interpreting the law.⁶⁵ Federal courts in the United States also adjudicate federal tax disputes as a neutral third-party.⁶⁶ State and local tribunals also adjudicate numerous tax-related disputes.

In sum, despite the similarities in some formal features, tax administration and tax compliance in China and the United States vary significantly. How then do Chinese companies in the United States react to the complex and law-based U.S. tax system? Does Chinese government ownership in an investor make any difference? Drawing on a unique set of data from a comprehensive survey of sizable Chinese investors in the United States, the following Part empirically explores these two important questions.

III. AN EMPIRICAL STUDY OF CHINESE COMPANIES IN THE U.S. TAX SYSTEM

This study relies on original data derived primarily from two annual surveys of China-based multinational companies in the United States that were conducted by the Chinese General Chamber of Commerce-USA (“CGCC”), the dominant Chinese business association in the United States.⁶⁷ The surveys, drafted in simplified Chinese, cover a wide array of topics including how the companies cope with the U.S. tax system. While the two annual surveys contain some identical questions, they differ in content as well as method of collection.

In 2014, the CGCC staff distributed the survey questionnaires in two ways. First, the survey went to all CGCC members. Most of the CGCC board and regional chapter members completed the questionnaires, thus ensuring a sample comprising a diverse body of large Chinese companies investing in the United States. The response rate, however, was much lower outside this group. Second, a senior staff member of the CGCC interviewed more than a dozen of executives of Chinese-invested companies, many of whom timely returned a completed questionnaire.⁶⁸ In the end, the CGCC received 101 completed questionnaires over two months.⁶⁹ In 2015, the CGCC staff relied solely on the survey questionnaires

65. For an elaborate history of the court and its importance, see David Laro, *The Evolution of the Tax Court as an Independent Tribunal*, 1995 U. ILL. L. REV. 17.

66. K. Martin Worthy, *The Tax Litigation Structure*, 5 GA. L. REV. 248, 248–50 (1971).

67. The Author of this Article participated in the survey project as a non-paid academic advisor, and provided comments on its administration and the analysis of the survey results.

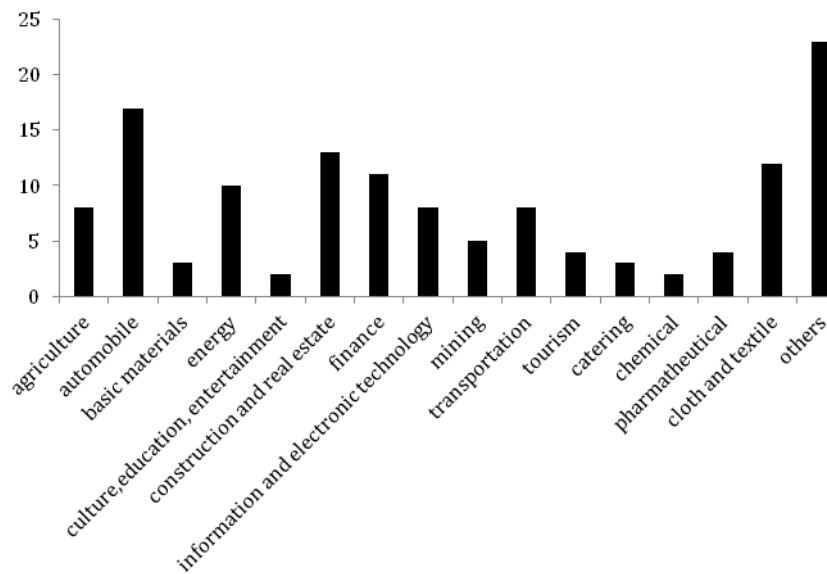
68. A CGCC staff member other than the interviewing director compiled the survey results to avoid possible feedback bias.

69. See CHINA GEN. CHAMBER OF COMMERCE – U.S.A., 年企业问卷普查表 [ANNUAL BUSINESS SURVEY ON CHINESE ENTERPRISES IN THE U.S.] (2014) (on file with *Hastings Law Journal*) [hereinafter 2014 CGCC SURVEY].

and collected 122 responses, most of which were completed by members of the CGCC board and the boards of its six regional chapters.⁷⁰

The high response rate from the CGCC board members ensures the quality of the data, as the CGCC normally elects sizable Chinese companies representing different sectors, locations, corporate structures, and ownership to lead the board and its regional chapters.⁷¹ As illustrated in FIGURE 2, the survey respondents invest in all major sectors in the United States. Moreover, consistent with the general trend of China-sourced FDI, the majority of the survey respondents entered the U.S. market in the past seven years.⁷² The sample is also diverse in terms of the survey respondents' investment location choice.⁷³

FIGURE 2: SECTORAL DISTRIBUTION OF SURVEY RESPONDENTS⁷⁴



70. See CHINA GEN. CHAMBER OF COMMERCE – U.S.A., 年企业问卷调查表 [ANNUAL BUSINESS SURVEY ON CHINESE ENTERPRISES IN THE U.S.] (2015) (on file with *Hastings Law Journal*) [hereinafter 2015 CGCC SURVEY].

71. Board of Directors of China General Chamber of Commerce—U.S.A., CHINA GEN. CHAMBER OF COMMERCE, <http://www.cgccusa.org/wp-content/uploads/2015/07/CGCC-Board-of-Directors2016.pdf> (last visited Mar. 11, 2017).

72. See discussion *infra* Part IV.

73. In line with findings from other studies of Chinese investment in the United States, California stands out as the most popular destination, which is trailed by New York and New Jersey. States in the Midwest and the South are also represented in the sample. See NAT'L COMM. ON U.S.-CHINA RELATIONS & RHODIUM GRP., NEW NEIGHBORS: CHINESE INVESTMENT IN THE US BY CONGRESSIONAL DISTRICT 48 (2015).

74. 2014 CGCC SURVEY, *supra* note 69.

In short, the survey sample represents a diverse group of large Chinese companies that invest in the United States. Standard measures were taken to ensure the validity of the survey responses. The primary benefit of using the survey methodology is to gain direct insights about managerial perceptions, considerations, and motives that are unobservable using archival data. Yet using this method also has its drawbacks. Problems common to all survey-based research, such as nonresponse bias and survival bias, will have to be addressed. On the other hand, selection bias is not a particular concern given that the study focuses on large Chinese companies in the United States and their response to the U.S. tax system. Evidently, Chinese-owned take-out restaurants and laundromats are insignificant to the ongoing debate, though they will certainly account for the majority in a random sample of all Chinese investors. Another concern of this study is its limited sample size. As Chinese companies only recently began to invest in developed countries, the pool of large Chinese investors in the United States remains relatively small. However, thanks to the board composition of the CGCC and the high response rate among its members, the sample represents an unbiased subset of the population of interest, that is, all large Chinese investors in the United States.

Before proceeding to the empirical analysis, the dual purposes of this study should be reiterated. First, it will empirically explore how China-based multinational companies interact with the U.S. tax system. For instance, will they comply strictly with U.S. law? Or, will they export substandard compliance practices perfected in their home state to the new institutional environment? Due to the lack of prior research on the subject, the Author is obligated to present a broad overview of the empirical findings. Second, the study investigates empirically the relationship between state ownership of the Chinese investors and their tendency to comply with the U.S. tax system.

To be more concrete, this Part proceeds with an empirical survey of the following five topics: (1) how China-based multinational corporations in the United States perceive their U.S. tax burdens; (2) to what extent they consider U.S. tax law to be rational; (3) given these perceptions, how the companies handle their tax matters; (4) the probability that they experience tax audits or disputes with the IRS; and (5) whether the China-based multinational companies engage in tax planning to minimize their U.S. tax liability. After the broad empirical overview, the study zooms in to statistically analyze the effects of Chinese government ownership on the probability of experiencing tax audits and disputes with the IRS and the probability of engaging in tax avoidance planning.

A. DESCRIPTION OF CHINESE COMPANIES IN THE U.S. TAX SYSTEM

1. *Perception of the U.S. Tax Burden*

As discussed earlier, the effect of tax rates on FDI inspires a vast amount of literature. Many scholars contend that a high tax rate hinders FDI, citing certain empirical findings of a negative correlation between the two.⁷⁵ Others argue the opposite, pointing to evidence of either a positive effect of high tax on FDI⁷⁶ or the failure of tax incentives to attract investment.⁷⁷ Still others find that tax incentives affect FDI in variable ways.⁷⁸ Thus, to understand how China-based multinational firms react to the U.S. tax system, it is imperative to start by assessing how they perceive the U.S. tax burden.

As shown in FIGURE 3, the majority of the respondents consider U.S. tax to be more onerous. Chinese law generally subjects large companies to a flat statutory rate of twenty-five percent on their taxable income.⁷⁹ By comparison, the U.S. government sets its statutory federal income tax rate for large U.S. companies at thirty-five percent.⁸⁰ Apart from the typical income tax, both governments usually require companies to pay and withhold certain payroll taxes. Under the formal Chinese law, companies should pay for five types of employment related insurance, totaling 42.3% of the employees' base salaries.⁸¹ In the United States, employers pay for Social Security at a rate of 6.2% of the wage, up to \$118,500, and they pay for Medicare at a rate of 1.45%.⁸² In addition, corporations in the United States normally have to pay state income tax at varying rates.⁸³

75. See, e.g., Kan H. Young, *The Effects of Taxes and Rates of Return on Foreign Direct Investment in the United States*, 41 NAT'L TAX J. 109, 115 (1988); Harry Grubert & John Mutti, *Taxes, Tariffs and Transfer Pricing in Multinational Corporate Decision Making*, 73 REV. ECON. & STAT. 285, 286 (1991); Hartman, *supra* note 14, at 485.

76. Swenson, *supra* note 11, at 261-62.

77. See, e.g., David Lim, *Fiscal Incentives and Direct Foreign Investment in Less Developed Countries*, 19 J. DEV. STUD. 207, 211 (1983); Moore et al., *supra* note 11, at 680.

78. Alexander Klemm & Stefan Van Parys, *Empirical Evidence on the Effects of Tax Incentives*, 19 INT'L TAX & PUB. FIN. 393, 395 (2012).

79. *People's Republic of China Enterprise Income Tax Law*, ch. 1, § 4 (promulgated by Tenth Nat'l People's Congr., Jan. 1, 2008), CENT. PEOPLE'S GOV'T OF THE PEOPLE'S REPUBLIC OF CHINA (Mar. 16, 2007) http://www.gov.cn/jlfq/2007-03/19/content_554243.htm.

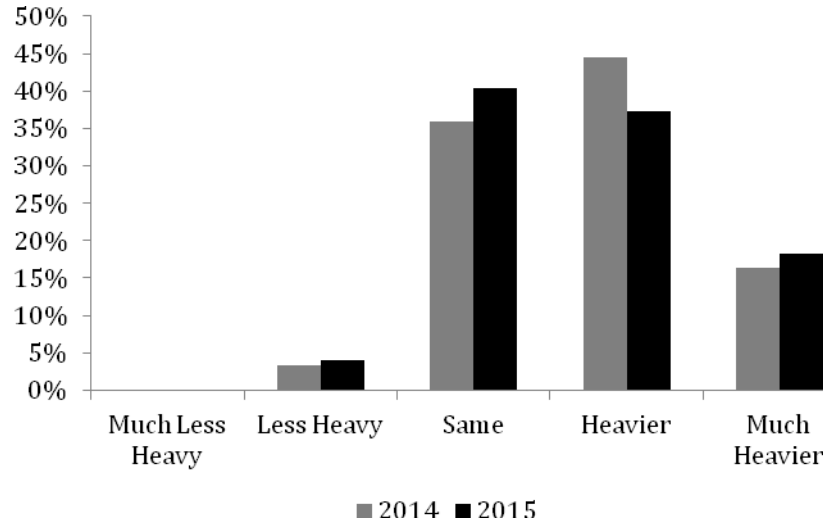
80. Omnibus Budget Consolidation Act of 1993, 26 U.S.C. § 11(b)(1) (2016).

81. *People's Republic of China Labor Law*, ch. 9, § 73 (promulgated by Standing Comm. of the Eighth Nat'l People's Cong., July 5, 1994), NAT'L PEOPLE'S CONGRESS, http://www.npc.gov.cn/wxzl/gongbao/2000-12/05/content_5004622.htm.

82. *Contribution and Benefit Base*, SOC. SECURITY ADMIN., <https://www.ssa.gov/oact/cola/cbb.html> (last visited Mar. 11, 2017).

83. Jared Walczak, *State Corporate Income Tax Rates and Brackets for 2015*, TAX FOUND. (Apr. 21, 2015) <http://taxfoundation.org/article/state-corporate-income-tax-rates-and-brackets-2015> (indicating that six states do not impose income tax on corporations, though three of them impose gross receipts taxes on business).

FIGURE 3: PERCEPTION OF U.S. TAX BURDEN IN COMPARISON TO CHINESE TAX BURDEN⁸⁴



Of course, even in the United States few companies pay tax at exactly the statutory rate, and the actual tax burden can vary significantly.⁸⁵ On average, the effective corporate tax rate in China is lower than that in the United States by a large margin.⁸⁶ Hence, the Chinese companies' comparative assessment of U.S. tax burden appears to be roughly accurate, in terms of both the statutory rates and the effective rates.⁸⁷

2. Perception of the U.S. Tax Law

Tax rate is but one part of the debate about the taxation of multinational corporations. Equally important are the structural features of a tax regime. The impact of said regime on FDI has generated a sizable body of literature. Studies have found that, besides corporate tax rate, ambiguous legal language, complex compliance procedures, and

84. 2014 CGCC SURVEY, *supra* note 69; 2015 CGCC SURVEY, *supra* note 70.

85. U.S. GOV'T ACCOUNTABILITY OFFICE, CORPORATE INCOME TAX: EFFECTIVE TAX RATES CAN DIFFER SIGNIFICANTLY FROM THE STATUTORY RATE 4 (2013).

86. The rate was 21.5% in China, compared to 27.7% in the United States. See PRICEWATERHOUSECOOPER, GLOBAL EFFECTIVE TAX RATES 3 (2011).

87. Some empirical evidence suggests that statutory rate difference has a more significant influence on foreign investment going into the United States. See Albert Wijeweera et al., *Corporate Tax Rates and Foreign Direct Investment in the United States*, 39 APPLIED ECON. 109, 116 (2007); Grubert & Mutti, *supra* note 75, at 285.

frequent and inconsistent changes in tax law all deter FDI.⁸⁸ Despite the valuable insights, the prior literature has neglected the fact that these different dimensions of a tax system are often inextricably linked with each other. For instance, relatively stable law may offset ambiguous legal language in terms of the effects on FDI. To account for such interlinks, I adopt a broad and holistic view of U.S. tax law. Moreover, though the same tax law can be simultaneously complex and simple to different foreign investors, the existing literature neglects the relative fluency with which foreign companies can take account of the structural factors. Presumably, companies from the U.K. are more likely than their Chinese counterparts to find the U.S. tax law easy to comprehend.

This Article explores how multinational corporations based in China—a country where law and courts govern weakly and only in certain circumstances⁸⁹—view the U.S. tax law. The CGCC surveys inquired about the respondents' general perception of the U.S. tax law, that is, whether it is more or less rational (“*he li*” in Chinese) than Chinese tax law. As illustrated in FIGURE 4, the survey respondents hold an overall positive perception of the U.S. tax law, although about half reported a neutral view. This suggests that China-based multinational companies—which are accustomed to Chinese tax administration permeated with official edicts, connections, ambiguous law, and weak courts—find the complex, yet law-based, U.S. tax system to be more sensible. This finding starkly contradicts the conventional wisdom that has been rather critical about the complex U.S. tax law.⁹⁰

88. See, e.g., Kelly Edmiston et al., *Tax Structures and FDI: The Deterrent Effects of Complexity and Uncertainty*, 24 FISCAL STUD. 341, 353 (2003); Martina Lawless, *Do Complicated Tax Systems Prevent Foreign Direct Investment?*, 80 ECONOMICA 1, 2 (2013).

89. For instance, the court may adjudicate fairly routine commercial cases where the litigants possess similar power sources. Ji Li, *When Are There More Laws? When Do They Matter? Using Game Theory to Compare Laws, Power Distribution, and Legal Environments in the United States and China*, 16 PAC. RIM L. & POL'Y J. 335, 347–48 (2007).

90. See, e.g., MICHAEL J. GRAETZ, 100 MILLION UNNECESSARY RETURNS: A SIMPLE, FAIR, AND COMPETITIVE TAX PLAN FOR THE UNITED STATES (2008); Michael J. Graetz, *Tax Reform Unraveling*, 21 J. ECON. PERSP. 69, 71–72 (2007); GARY CLYDE HUFBAUER & PAUL L. E. GRIECO, REFORMING THE US CORPORATE TAX (2005); Jane G. Gravelle, *Practical Tax Reform for a More Efficient Income Tax*, 30 VA. TAX REV. 389 (2010).

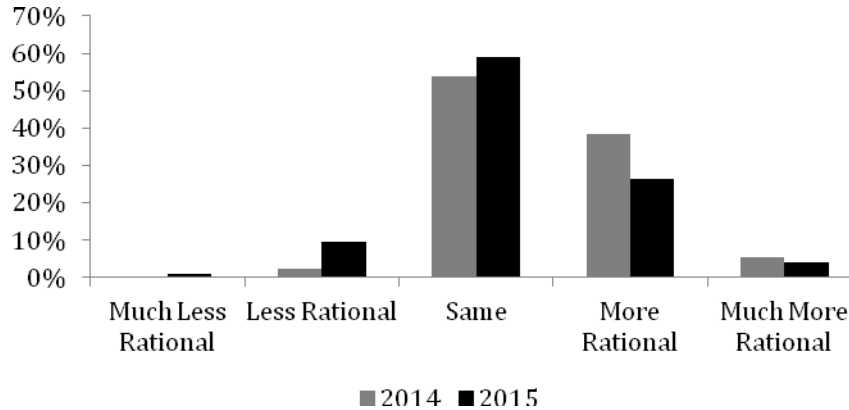


FIGURE 4: U.S. TAX LAW IN COMPARISON WITH CHINESE TAX LAW⁹¹

3. Handling U.S. Tax Matters

Faced with the huge gaps between the Chinese tax system and the complex, law-based U.S. tax system, how do Chinese multinational companies react? As previous scholarship has demonstrated, tax practitioners play a crucial part in tax compliance.⁹² Empirical evidence abounds that taxpayers seeking the assistance of tax professionals vary significantly from those who prepare tax returns themselves.⁹³ Some find that, after controlling for the selection effect, the use of an attorney or CPA to prepare returns increases tax noncompliance.⁹⁴ Yet contradictory empirical evidence also exists.⁹⁵ While the debate continues, little scholarly attention so far has been paid specifically to the use of tax practitioners by multinational companies from emerging markets.

U.S. tax compliance, highly complex even in the eyes of domestic taxpayers,⁹⁶ inevitably constitutes a “liability of foreignness” for Chinese

91. 2014 CGCC SURVEY, *supra* note 69; 2015 CGCC SURVEY, *supra* note 70.

92. Steven Klepper et al., *Expert Intermediaries and Legal Compliance: The Case of Tax Preparers*, 34 J.L. & ECON. 205, 228 (1991).

93. James Andreoni et al., *Tax Compliance*, 36 J. ECON. LITERATURE 818, 847 (1998).

94. Brian Erard, *Taxation with Representation: An Analysis of the Role of Tax Practitioners in Tax Compliance*, 52 J. PUB. ECON. 163, 196 (1993); Klepper et al., *supra* note 92, at 206–07 (finding that the use of tax professionals is associated with increasing noncompliance in situations of legal ambiguities).

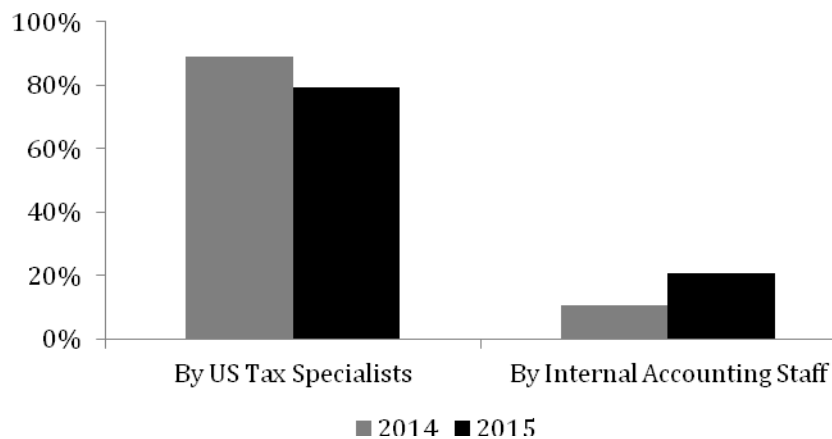
95. Peggy A. Hite & Gary A. McGill, *An Examination of Taxpayer Preference for Aggressive Tax Advice*, 45 NAT'L TAX J. 389, 399 (1992).

96. See Andreoni et al., *supra* note 93, at 846 (indicating that about half of all U.S. taxpayers employ tax practitioners to prepare their tax returns).

companies.⁹⁷ Understanding how they react will help address a widely-shared concern that growing Chinese outbound FDI will spread poor corporate governance and noncompliance to the host countries.⁹⁸ If China-based multinational corporations rely heavily on local professionals for compliance, it is reasonable to expect a relatively smooth transition.

The surveys inquired about the respondents' handling of U.S. tax matters, namely whether they handle the matters internally or outsource them to U.S. specialists. According to the survey results, the vast majority of the respondents chose to delegate the work (see FIGURE 5). As previously noted, the reliance on U.S. professionals does not, *ipso facto*, indicate high compliance.⁹⁹ Nonetheless, the finding of broad reliance on U.S. tax practitioners suggests that U.S. tax agencies may be able to regulate multinational companies from emerging markets more effectively through their professional service providers.

FIGURE 5: DEALING WITH U.S. TAX MATTERS¹⁰⁰



4. Tax Audits and Disputes with the IRS

The empirical evidence thus far has portrayed China-based multinational companies in the United States to be willing and capable of adapting to the complex U.S. tax system. Hence, one would not expect

97. B. Elango, *Minimizing Effects of 'Liability of Foreignness': Response Strategies of Foreign Firms in the United States*, 44 J. WORLD BUS. 51, 51 (2009).

98. Li, *supra* note 23, at 152.

99. Previous research has suggested that relying on tax practitioners may facilitate compliance in cases of clear tax rules and noncompliance when there is ambiguity. *See, e.g.*, Klepper et al., *supra* note 92, at 206-09.

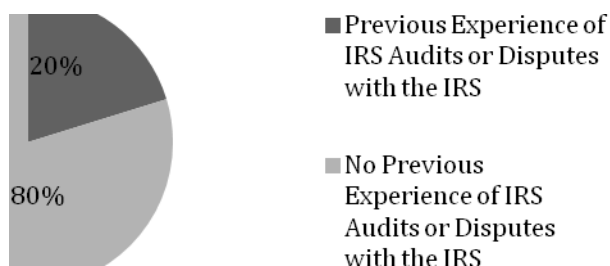
100. 2014 CGCC SURVEY, *supra* note 69; 2015 CGCC SURVEY, *supra* note 70.

extraordinary frictions between these companies and the U.S. institutions for tax administration. This Subpart empirically explores the validity of that hypothesis.

Administrative enforcement measures, such as tax audits, constitute the fulcrum of tax compliance.¹⁰¹ Under the rational choice theories that have guided policymaking regarding tax collection for decades, taxpayers comply with tax law if the costs associated with audit and penalty exceed the benefits of tax evasion.¹⁰² A sizable body of empirical work demonstrates the importance of tax audits and penalties in shaping compliance behavior.¹⁰³ However, the literature has neglected foreign-controlled firms in the United States.

A closely related issue is tax controversy, which typically follows an audit and deficiency assessment. As noted earlier, while U.S. taxpayers adjudicate tax disputes from time to time, taxpayers very rarely sue tax agencies in China.¹⁰⁴ Does that change when the Chinese companies move to operate in the United States? So far no empirical research has even marginally examined the question. Given that FDI originating from the developing countries is very much a recent phenomenon, the empirical literature on tax controversies has not caught up to the reality of the current situation.

FIGURE 6: IRS AUDITS OR DISPUTES WITH THE IRS¹⁰⁵



101. See, e.g., Barbara Kastlunger et al., *Sequences of Audits, Tax Compliance, and Taxpaying Strategies*, 30 J. ECON. PSYCHOL. 405, 417 (2009); Arthur Snow & Ronald S. Warren Jr., *Ambiguity About Audit Probability, Tax Compliance, and Taxpayer Welfare*, 43 ECON. INQUIRY 865, 870 (2005); James Alm et al., *Audit Selection and Income Tax Underreporting in the Tax Compliance Game*, 42 J. DEV. ECON. 1, 1 (1993); H. Cremer et al., *Evading, Auditing and Taxing: The Equity-Compliance Tradeoff*, 43 J. PUB. ECON. 67, 67 (1990).

102. For a general introduction to the framework, see Michael G. Allingham & Agnar Sandmo, *Income Tax Evasion: A Theoretical Analysis*, 1 J. PUB. ECON. 323 (1972).

103. See, e.g., Kastlunger et al., *supra* note 101; Cremer et al., *supra* note 101. 2014 CGCC SURVEY, *supra* note 69; 2015 CGCC SURVEY, *supra* note 70.

104. Li, *supra* note 32, at 58.

105. 2014 CGCC SURVEY, *supra* note 69. There were eighty-nine responses to this particular survey question. See *id.*

The 2014 Survey collected information about the respondents' prior experience as to tax audits or disputes with the IRS. As shown in FIGURE 6, a significant minority of eighteen (twenty percent) reported that they had such prior experiences and seventy-one (eighty percent) of Chinese investors did not. The ratio is low considering that the median respondent has operated in the United States for seven years and the survey sample includes most of the large Chinese-invested firms.¹⁰⁶ Because the IRS chooses its audit targets using a variety of methods, including random selection and a Discriminant Information Function formula that calculates the probability of positive tax adjustments,¹⁰⁷ the relatively low audit rate may be attributed to the Chinese companies' insignificant taxable income. However, the empirical tests regarding the effect of Chinese government ownership presented in the next Subpart suggest that corporate revenue or profit is not a key explanation.

5. Tax Avoidance

Corporations have myriad ways to reduce their tax liabilities. The existing literature has thoroughly examined the nexus between global capital flows, in particular investment of multinational corporations, and tax inducements.¹⁰⁸ Most large foreign companies, however, cannot afford to completely avoid the U.S. market, so they adopt and implement various tax planning strategies to minimize their U.S. tax.¹⁰⁹ As shown previously, Chinese investors consider the U.S. tax to be heavy and they delegate their tax work to U.S. accounting professionals. This begs the question as to whether, and to what extent, the China-based multinational corporations engage in tax planning to avoid U.S. tax.

106. For comparison, I use as a benchmark a predicted average IRS audit rate for the respondent sample calculated from averaging the rates associated with various asset amounts of C corporations provided in the IRS Data Book. INTERNAL REVENUE SERV., INTERNAL REVENUE SERVICE DATA BOOK 2012 22–23 (2012), <http://www.irs.gov/pub/irs-soi/12databk.pdf>. Assuming the audit is temporally independent and across different Chinese invested firms, the asset value of the survey respondents did not change, and dividing the respondents into two categories (one assigned the audit rate of two percent for companies with assets of less than ten million, the other ten percent for firms with larger assets), the expected probability of having experienced an IRS audit would be 32.7%. That is much higher than the 20.2% from the survey report.

107. DeBacker et al., *supra* note 22, at 125.

108. See all sources cited *supra* note 3.

109. For the description and analysis of a few well-known international tax planning strategies, see Edward D. Kleinbard, *Through a Latte, Darkly: Starbucks's Stateless Income Planning* (Ctr. in Law, Econ. & Org., Research Paper No. C13-9, 2013); Paul M. Schmidt et al., *Why Tax Inversions Continue to Be an Effective Global Tax Planning Strategy*, 32 J. TAX'N INV. 3 (2015); Joseph P. Brothers, *From the Double Irish to the Bermuda Triangle*, 2014 TAX NOTES INT'L 687.

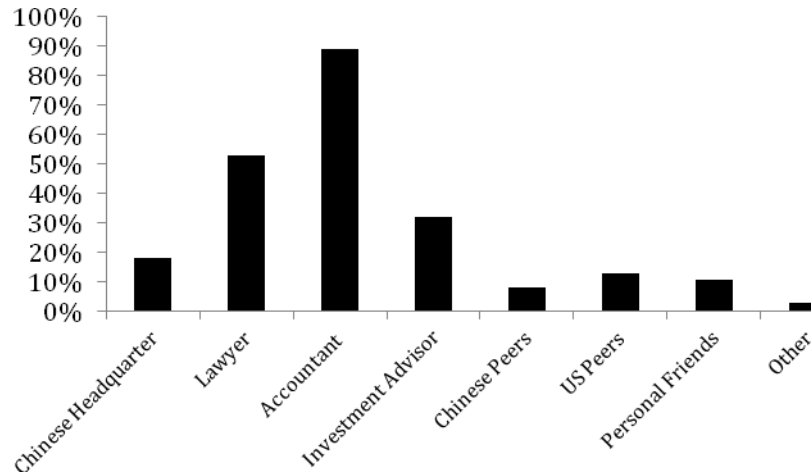
FIGURE 7: TAX AVOIDANCE BY CHINESE-INVESTED COMPANIES¹¹⁰

The 2015 CGCC Survey collected information about the respondents' tax planning.¹¹¹ According to the survey data, thirty-nine respondents (forty-one percent) took, or plan to take, actions to avoid U.S. tax. Compared to the ratio for large U.S.-based companies, this ratio is low. Because tax planning requires sophisticated knowledge of U.S. tax law, Chinese companies were expected to obtain relevant information from tax specialists. Indeed, thirty-four (eighty-nine percent) of the companies that engage, or plan to engage, in tax planning receive their information from accountants, followed by twenty (fifty-three percent) that acquire the information from lawyers. Only a few obtained their know-how from their peers or their Chinese headquarters. So, the Chinese multinational companies are acting very much like their U.S. domestic counterparts in terms of gathering information about tax planning.

110. 2015 CGCC SURVEY, *supra* note 70. There were ninety-five responses to this particular survey question. *See id.*

111. To mitigate bias as tax avoidance may be viewed as lacking legitimacy; the respondents were asked whether they had engaged in "legitimate" or "reasonable" tax avoidance. *See id.*

FIGURE 8: SOURCE OF INFORMATION FOR U.S. TAX AVOIDANCE¹¹²



To summarize, drawing on original data from two comprehensive surveys of Chinese companies investing in the United States, this Subpart presents an empirical overview of how China-based multinational companies react to the intricate, law-based U.S. tax system. Chinese companies consider U.S. tax more burdensome than Chinese tax, yet they maintain a positive perception of U.S. tax law. This perception indicates their preference for the law-based U.S. system over the power- or relationship-based tax administration and compliance in China. In addition, large Chinese investors delegate their tax work to U.S. specialists, and they are less likely to experience tax audits or disputes with the IRS. Though a significant minority of the respondents engage in tax planning to minimize their U.S. tax, the ratio is relatively low compared to large U.S. domestic companies. According to this empirical overview, Chinese multinational companies that invest in the United States respond to the U.S. tax system in ways similar to U.S. firms. In other words, there is no convincing evidence that the China-based multinational corporations are less compliant with U.S. tax law, despite the extensive institutional distance between the two countries.

¹¹² 2015 CGCC SURVEY, *supra* note 70. There were thirty-eight responses to this particular survey question. *See id.*

B. REGRESSION ANALYSIS OF THE EFFECT OF CHINESE GOVERNMENT OWNERSHIP

Though the high-level empirical overview portrays highly adaptive Chinese multinational companies coping well with the U.S. tax system, the survey data also demonstrates significant firm level variations (see TABLE 3). In other words, all the Chinese companies in the United States are not the same in terms of tax compliance. Among the factors that may be relevant, this Article focuses on the important yet underexplored role of state ownership. As discussed earlier, the visible hand of the state is prominently featured in China's outward FDI as well as the FDI from other emerging markets. To be more specific, this Subpart statistically analyzes how Chinese government ownership in the investors affects the two variables central to U.S. tax compliance: (1) tax audits and disputes with the IRS; and (2) tax avoidance.

1. *Tax Audits and Disputes with the IRS*

The existing empirical studies present convincing evidence that foreign laws, regulations, and norms have significant influence on foreign persons' compliance behavior in the United States,¹¹³ including foreign companies' U.S. tax compliance.¹¹⁴ But so far few scholars have investigated the key institutional determinants of FDI from emerging markets, such as the visible hand of the state. This Subpart fills the gap by statistically probing the nexus between government ownership in a Chinese multinational company and its tax compliance in the host country.

As discussed in Part II, power status plays a pivotal role in shaping the interactions between corporate taxpayers and tax agencies in China. While routine tax matters may be dealt with in accordance with rules and conventional practices, different compliance models apply in cases involving legal uncertainties or substantially diverging interests. The state-owned enterprises ("SOEs"), given their political status, treat Chinese tax agencies as peers in the government structure and resolve thorny tax issues or disputes through negotiations, not in the shadow of the law, but according to their political status and the interests at stake.¹¹⁵ By comparison, large Chinese private companies rely more on formal law to mitigate tax compliance risk in China. Thus, it should appear that state-invested Chinese companies in the United States confront more challenges than their large private peers in adapting to a law-based regulatory environment.

In addition, SOEs' organizational rigidity and agency problems may hinder their adaptation to local rules and prevent flexible resolution of tax

113. Fisman & Miguel, *supra* note 22, at 1023.

114. DeBacker et al., *supra* note 22, at 2-6.

115. Cui, *supra* note 50, at 109.

disputes.¹¹⁶ Because SOE employees' compensation is not efficiently aligned with their contribution to corporate profit, they tend to avoid risk taking by following the instructions of their superiors or internal guidelines.¹¹⁷ Such behavior, perfectly rational for individual SOE employees in the United States, may increase the risk of tax noncompliance and thwart the settlement of disputes. Hence, I hypothesize that Chinese government-invested businesses in the United States are more likely to experience tax audits and disputes with the IRS than their privately-invested counterparts.

- **Tax Audits and Disputes with the IRS.** The 2014 CGCC Survey collected data regarding the Chinese firms' tax audits and disputes with the IRS.¹¹⁸ To statistically test the above hypothesis, I create a dummy variable that takes the value of one if the survey respondent reported prior audits or disputes with the IRS—otherwise the dummy variable takes the value of zero.
- **State Ownership in the Investors.** For the independent variable of interest (Chinese government ownership), I create a dummy variable that equals one if a Chinese government entity controls at least fifty percent of the equity interest of the investor. Some scholars contend that majority state ownership is not a necessary condition for the Chinese government to exert control or influence over corporations.¹¹⁹ Thus, I also create an alternate dummy variable that broadens the definition by treating Chinese investors as state-owned if Chinese government entities own more than ten percent of the equity interest. I draw the line at ten percent, a conventional threshold in major regulatory areas, to separate companies with state ownership from essentially private Chinese companies. The regression tests below will alternately include the two dummies (fifty percent state ownership and ten percent state ownership) to fully assess the effect of Chinese government ownership. Additionally, to account for confounding effects of other possible explanatory factors, I include a number of control variables, the description of which follows.

116. See, e.g., Xiaoming He et al., *The Renaissance of State-Owned Multinationals*, 58 THUNDERBIRD INT'L BUS. REV. 117, 118 (2016); Zhou Mi & Xiaoming Wang, *Agency Cost and the Crisis of China's SOE*, 11 CHINA ECON. REV. 297 (2000).

117. For the discussion about executive compensation and corporate performance relating to Chinese SOEs, see Martin J. Conyon & Lerong He, *Executive Compensation and Corporate Governance in China*, 17 J. CORP. FIN. 1158 (2011); Michael Firth et al., *Corporate Performance and CEO Compensation in China*, 12 J. CORP. FIN. 693 (2006); Taye Mengistae & Lixin Colin Xu, *Agency Theory and Executive Compensation: The Case of Chinese State-Owned Enterprises*, 22 J. LAB. ECON. 615 (2004).

118. 2014 CGCC SURVEY, *supra* note 69.

119. See, e.g., Curtis J. Milhaupt & Wentong Zheng, *Beyond Ownership: State Capitalism and the Chinese Firm*, 103 GEO. L.J. 665, 670 (2015).

- **Years of Investing in the United States.** For the following reasons, the statistical tests include as a control the duration of a company's operation in the United States. First, it may have some confounding effect if Chinese investors, having operated in the United States for an extended period (many of them state-owned), have fully internalized or grown accustomed to the complex tax rules. Second, investment duration may offer crucial hints about potential survival bias. Chinese investors that experience major tax compliance issues may withdraw from the U.S. market earlier than others. The former would be absent from the sample, resulting in a sampling bias. According to the 2014 Survey, the data for this variable largely parallels the trajectory of Chinese FDI. An average Chinese investor in the sample had operated for about ten years in the United States (see TABLE 1), but the majority entered the U.S. market in the past seven years.¹²⁰
- **Profit Level.** U.S. corporate tax is generally levied on net income,¹²¹ and the probability of tax audits positively correlates with corporate taxable income, so I control for the profit level of a Chinese-invested business in the United States. A 2014 Survey question inquired about the respondents' profit or loss for the year of 2013. The question was structured on a scale of one to five, with one being "incurred heavy losses" and five being "highly profitable."¹²² The control variable draws data directly from this question. As shown in TABLE 1, the mean value is 2.88, indicating that on average the China-based multinational companies incurred a slight loss from their U.S. businesses. One would expect such a result given the competitiveness of the U.S. market, the short history of Chinese investment in the country, and the significant "liability of foreignness" for the Chinese investors.¹²³
- **Reliance on U.S. Professionals.** Chinese companies in the United States rely heavily on local professionals to handle their tax matters. The existing literature on this topic illustrates that the use of professional tax service has measurable effects on compliance behavior.¹²⁴ The same may apply to Chinese companies in the United States, so I add the dummy variable of professional service to the regression tests. The dummy assumes the value of one if the survey respondent delegates its tax work to U.S. accounting specialists, otherwise the dummy variable is set at zero.

120. 2014 CGCC SURVEY, *supra* note 69.

121. Consolidated Appropriations Act, 26 U.S.C. §§ 162, 163, 165 (2016).

122. 2014 CGCC SURVEY, *supra* note 69.

123. The term "liability of foreignness" refers to the costs incurred by multinational corporations doing business abroad "arising from the unfamiliarity of the environment, from cultural, political, and economic differences, and from the need for coordination across geographic distance." Srilata Zaheer, *Overcoming the Liability of Foreignness*, 38 ACAD. MGMT. J. 341, 341 (1995).

124. See all sources cited *supra* notes 92–94.

- **Revenue and Assets.** The size of a Chinese investor’s U.S. business may also relate to both its ownership structure and the dependent variables of interest. For instance, the Chinese government may disproportionately invest in companies with larger operations in the United States and higher revenues may raise both U.S. tax and compliance issues.¹²⁵ A survey question about the dollar amount of 2013 revenues from U.S. investments provides the data used to extrapolate this idea. Adding this covariate, however, reduces the sample size, as some respondents were reluctant to disclose the information (see TABLE I).

Revenues are annual figures. An alternative measure of investment size is the dollar amount of the investors’ U.S. assets by the end of 2013. Similar to the data on revenues, only a portion of the respondents chose to answer the asset question. To allay the problem of missing data and to capture the potential effect of investment size, I use the logarithmic values of reported revenue and asset amounts alternately in the regression tests that follow.

TABLE I: SUMMARY STATISTICS¹²⁶

Variable	Observations	Mean	Std. Dev.	Min.	Max.
State owning more than 10% of Chinese investor	95	0.568	0.498	0	1
State owning more than 50% of Chinese investor	95	0.484	0.502	0	1
Tax matters handled by U.S. professionals	92	0.891	0.313	0	1
Previous experience of audit or dispute with IRS	89	0.202	0.404	0	1
Years of investing in U.S.	98	10.60204	9.438613	1	35
Profit level	85	2.882353	1.00489	1	5
Asset (log)	64	3.386937	1.388602	0.2552725	6.939519
Revenue (log)	61	2.994716	1.670203	-3	5.439175

125. As a result of the SOE reforms in the 1990s, the state retained ownership primarily in large enterprises. See, e.g., Yongnian Zheng & Minjia Chen, *China’s State-Owned Enterprise Reform and Its Discontents*, 56 PROBS. POST-COMMUNISM 36, 37 (2009).

126. 2014 CGCC SURVEY, *supra* note 69.

Given the limited sample size and the binary dependent variable, I first use exact logistic regression tests to assess the relationship between state ownership in Chinese investors and the probability of experiencing an IRS audit or a dispute with the agency. When exact logistic tests are not practical, I use regular logistic regressions. The test results presented below in TABLE 2 suggest that majority government ownership is associated with a heightened probability of being audited or becoming involved in a dispute with the IRS. When broadened to include significant minority ownership the variable loses much of its significance, which indicates that majority control plays a critical role in shaping the actions of the invested businesses in the United States. Moreover, outsourcing the work to U.S. accountants does not appear to alter the odds, nor does the size of the investment or its profitability seem to matter.¹²⁷

The regression result confirms the hypothesis that Chinese government-owned firms experience more tax audits and disputes with the IRS. As previously noted, in China, elevated political status allows the SOEs to follow a mixed political-legal model in tax compliance. While accountants deal with routine tax matters, the SOEs normally resolve controversies through negotiations with the agencies as equals. And the Chinese government generally makes or amends tax rules to accommodate the special interests or needs of the SOEs.¹²⁸ Having left the power-based regulatory ecosystem, the state-owned Chinese companies no longer possess the bargaining leverage vis-à-vis law enforcement agencies. Instead, their old ways of dealing with tax rules and government agencies amplify the risk of audit and tax controversy in the United States.

127. IRS audit rates typically correlate well with the amount of total assets of C corporations and pass-through entities. *See, e.g.*, INTERNAL REVENUE SERV., *supra* note 106. The counterintuitive finding may be explained by the fact that most of the Chinese-invested companies in the sample are still at an early stage of loss-generating operations.

128. Cui, *supra* note 50.

TABLE 2: IRS AUDITS OR DISPUTES WITH THE IRS (PART I)¹²⁹

	(1)	(2)	(3)	(4)
State owning more than 10% of Chinese investor		2.93		2.74
State owning more than 50% of Chinese investor	3.66*		3.43*	
Years of investment in U.S.	1.03	1.04	1.03	1.04
Profit level	1.68 [†]	1.64	1.65	1.61
Tax matters dealt with by U.S. professionals			1.37	1.31
Revenue 2013 (log)				
Asset (log)				
N	73	73	72	72

TABLE 2: IRS AUDITS OR DISPUTES WITH THE IRS (PART II)¹³⁰

	(5)	(6)	(7)	(8)
State owning more than 10% of Chinese investor		3.11		4.23*
State owning more than 50% of Chinese investor	3.98*		5.63**	
Years of investment in U.S.	1.05	1.05	1.03	1.03
Profit level	1.23	1.22	1.12	1.11
Tax matters dealt with by U.S. professionals	1.10	0.98	1.37	1.22
Revenue 2013 (log)			1.48	1.51
Asset (log)	1.46	1.46		
N	56	56	56	56

Significance level: ***p < 1%; **p < 5%; *p < 10%; †p < 15%

129. 2014 CGCC SURVEY, *supra* note 69.

130. *Id.*

Models 1–4 use exact logistic regressions; the rest of the models (5–8) use regular logistic regressions due to lack of software memory. TABLE 2 reports odds ratios.

An alternative explanation may attribute the regression results to state-owned Chinese multinational companies being slow and less flexible in adjusting internal corporate structure and transaction procedures to suit local conditions, which inevitably gives rise to more conflicts. And in resolving a conflict, the risk averse managers of state-invested businesses may have to follow certain bureaucratic procedures that hinder early settlement. The survey does not contain direct evidence to test the potential explanation, but circumstantial evidence suggests firms with Chinese government ownership tend to rely upon their Chinese headquarters to decide how to resolve disputes in the United States.¹³¹ Such allocation of decisionmaking power inevitably hinders effective resolution of U.S. tax issues. In other words, if all the final decisions are made by the Chinese headquarters that have no access to the contexts and details of the conflicts, the U.S. operations will likely face more tax audits or disputes with the IRS.

If the IRS systematically targeted Chinese state-owned companies in the United States for audit, this would provide yet another potential explanation for the link between Chinese government ownership and audit rates. Though this study does not contain sufficient direct evidence to substantiate this hypothesis, a controlled test returns a significant positive correlation between state ownership and satisfaction with the IRS.¹³² Thus, it seems unlikely that the IRS singles out state-owned multinational companies for audits.¹³³

To summarize, the sizable China-based multinational firms report a relatively low rate of IRS audit or tax controversy. Overall, the group may engage in less cheating. Or, their losses make them less visible targets for IRS enforcement measures. However, all the Chinese companies are not the same. And Chinese government ownership correlates significantly with heightened risk of agency scrutiny or conflict, which indicates that Chinese state-invested firms in the United States face more hurdles than large

131. The 2014 Survey collected information about how decisions regarding dispute resolution in the United States were made. In the multiple choice question, a significant minority selected “Chinese headquarter” as the decisionmaker, with or without the assistance of U.S. lawyers, local executives, and local in-house counsel. In a simple logistic regression analysis, Chinese government ownership in an investor—defined as Chinese government entity owning at least ten percent of the equity interest in the investor—is significantly (at the ten percent level) correlated with a higher probability that the Chinese headquarter is having the final say. *See* 2014 CGCC SURVEY, *supra* note 69. Regression results on file with Author and available upon request.

132. In other words, responding firms owned by the Chinese government tended to hold more positive views about the services of the IRS.

133. The 2015 CGCC Survey contained a question about selective enforcement of rules in the United States. According to the data, many of the survey respondents believe that U.S. tax agencies unfairly target foreign companies for audits. *See* 2015 CGCC SURVEY, *supra* note 70.

private Chinese companies with respect to adapting to the complex U.S. regulatory regime.

2. *Tax Planning to Avoid U.S. Tax*

The renaissance of SOEs in the global economy triggered some renewed interest in their tax behavior.¹³⁴ Under the conventional view, SOEs should be insensitive to corporate tax as the government shareholder is also the tax collector.¹³⁵ However, the agency problem inherent in all large corporations, state-owned or not, suggests the answer is less than clear.¹³⁶ On the one hand, the managers of SOEs may engage in empire building by maximizing after-tax earnings and profits. On the other, they may refrain from aggressive tax planning for lack of adequate compensation. Recent empirical research on the tax behavior of SOEs has yet to produce conclusive evidence and no study has explored the tax planning of Chinese SOEs outside China.¹³⁷ This Article contributes to the debate by statistically examining the effects of Chinese government ownership on investors and their tax avoidance in the United States.

First of all, it is important to note that the unity argument for SOEs' lack of tax sensitivity does not apply in the present study. Apparently, the government owner of the investors and the taxing authority are not identical, at least not for the investors' U.S.-sourced income. But that does not necessarily mean Chinese state-owned investors are as sensitive to U.S. tax as their private counterparts. While the inherent agency problem may well justify the taxation of SOEs domestically, the same problem also weakens the managers' incentives to engage in risky tax avoidance behavior abroad. Though the political power of the SOEs mitigates the risk of tax planning in China, they do not enjoy that kind of privilege in tax compliance in the United States. Without adequate compensation for the heightened risk, the managers should avoid engaging in tax avoidance. The conflicting theories will be assessed with empirical tests.

- **U.S. Tax Avoidance.** The 2015 and 2016 CGCC Survey collected information about the Chinese companies' tax planning in the United States. For the dependent variable of tax avoidance, I draw on relevant survey data and create a dummy variable that equals one if the respondent has taken, or plans to take, any action to avoid U.S. tax, and zero if the respondent has not taken, and does not plan to take, any tax avoidance action. As shown in FIGURE 7, forty-one percent of the

134. Cui, *supra* note 50.

135. See, e.g., Harry Huizinga & Soren Bo Nielsen, *Privatization, Public Investment, and Capital Income Taxation*, 82 J. PUB. ECON. 399, 400-01 (2001).

136. Cui, *supra* note 50.

137. Clemens Fuest & Li Liu, *Does Ownership Affect the Impact of Taxes on Firm Behavior? Evidence from China* (Ctr. for Econ. Stud. & Ifo Inst., Working Paper No. 5316, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2603177.

Chinese companies have engaged, or plan to engage, in such actions to minimize their U.S. tax.

- **State Ownership.** The independent variable of interest is state ownership in the Chinese investor. Following the preceding regression tests, I create a dummy variable that equals one if a Chinese government entity owns at least fifty percent of the investor and zero if the government does not own fifty percent. In addition, I employ an alternative dummy variable to gauge the subtle influence of state ownership—the dummy takes the value of one if a Chinese government owns at least ten percent of the investor, zero if not.

Moreover, in order to control for the potential confounding effects of some lurking factors, I include the following variables to the regression tests.

- **Years of Investing in the United States.** The duration of a respondent's business operation may be associated with tax planning and state ownership. Chinese companies that have done business in the United States for an extended period may have accumulated more necessary tax avoidance knowledge than newcomers. Meanwhile, state-owned companies entered the U.S. market earlier than private-owned Chinese companies because of FDI restrictions the Chinese government imposed before the 1990s.¹³⁸ Moreover, adding the variable of investment duration helps assess the existence and scale of survival bias.
- **Reliance on U.S. Professionals.** As noted already, previous scholarship demonstrates that tax practitioners play a crucial part in tax compliance.¹³⁹ Taxpayers who seek the assistance of tax professionals vary significantly in tax compliance behavior from those who prepare returns themselves.¹⁴⁰ One study shows that the use of an attorney or CPA to prepare returns may actually increase noncompliance.¹⁴¹ However, evidence of the opposite also exists,¹⁴² which counsels for the control of this variable. Additionally, including the variable is of significant interest by itself because no prior study has thus far explored the use of tax practitioners by multinational corporations based in emerging markets. This test will begin to fill the void.

138. Peter J. Buckley et al., *Historic and Emergent Trends in Chinese Outward Direct Investment*, 48 *MGMT. INT'L REV.* 715, 723 (2008).

139. Klepper et al., *supra* note 92, at 205.

140. Andreoni et al., *supra* note 93, at 847.

141. Erard, *supra* note 94, at 196.

142. Hite & McGill, *supra* note 95, at 399.

- **Corporate Profit.** As noted, the United States generally levies corporate tax on net income,¹⁴³ and state ownership may correlate to both profit level and tax avoidance behavior. Thus, the statistical tests control for the profit level of a Chinese-invested business. The 2015 Survey, however, replaced the profit level question in 2014 with one that directly asks the respondent to report the amount of profit, which resulted in a relatively high nonresponse rate. Coupled with the nonresponsiveness in the revenue question, little valid data was obtained for calculating profit ratio. To mitigate the problem, I create a dummy variable that equals one if the respondent reported some profit and zero if the respondent reported no profit. The 2016 survey resumed the use of a scaled question for profit; I convert the data to the same dummy as the one for the 2014 data.
- **Revenue.** The size of a Chinese investor’s U.S. business may also relate to both its ownership structure and tax avoidance. The Chinese government may invest disproportionately in companies with larger operations in the United States and higher revenues may raise both U.S. tax and the incentive for tax planning. I also add a survey year dummy to account for changes over time.

TABLE 3: SUMMARY STATISTICS¹⁴⁴

Variable	Mean	Std. Dev.	Min	Max	Observations
State owning more than 10% of Chinese investor	0.485106	0.500845	0	1	235
State owning more than 50% of Chinese investor	0.395745	0.490054	0	1	235
Years of investment in the U.S.	11.6875	10.01661	0	40	224
Revenue	2.160221	1.225547	1	4	181
U.S. Profit	0.369942	0.48419	0	1	173
Tax avoidance	0.47907	0.500728	0	1	215
Reliance on U.S. professionals	.8565022	.3513684	0	1	223

143. Consolidated Appropriations Act, 26 U.S.C. §§ 162, 163, 165 (2016).

144. 2015 CGCC SURVEY, *supra* note 70; CHINA GEN. CHAMBER OF COMMERCE – U.S.A., 年企业问卷调查表 [ANNUAL BUSINESS SURVEY ON CHINESE ENTERPRISES IN THE U.S.] (2016) (on file with *Hastings Law Journal*) [hereinafter 2016 CGCC SURVEY].

TABLE 4: TAX AVOIDANCE (PART I)¹⁴⁵

	(1)	(2)	(3)	(4)
State owning more than 10% of Chinese investor	.53636* (.2970049)		.5459396* (.3018057)	
State owning more than 50% of Chinese investor		.3541819 (.3081277)		.4452557 (.3122889)
Years of investment in U.S.	-.0135858 (.0144547)	-.0124687 (.0147294)	-.0116318 (.0153676)	-.0115268 (.0156077)
Reliance on U.S. Professionals			.0408154 (.236793)	.0352397 (.2359112)
U.S. Profit				
U.S. Revenue				
Survey Year				
N	199	199	195	195

TABLE 4: TAX AVOIDANCE (PART II)¹⁴⁶

	(5)	(6)	(7)	(8)
State owning more than 10% of Chinese investor	.4351979 (.3639124)		.2867378 (.3778607)	
State owning more than 50% of Chinese investor		.4600699 (.3792251)		.3558072 (.388492)
Years of investment in U.S.	-.0168151 (.018017)	-.0178459 (.0182739)	-.0224693 (.0185817)	-.0241339 (.0189153)
Reliance on U.S. professionals	-.9901422* (.5618796)	-1.041076* (.5620255)	-.8706494 (.5710053)	-.9018838 (.5721871)
U.S. Profit	.5434674 (.4321086)	.5399483 (.4321329)	.2920099 (.4622435)	.2661255 (.4646803)
U.S. Revenue			.2730373 (.1674436)	.2795644* (.1650283)
Survey Year	1.315869* (.7390518)	1.390711* (.7361988)	1.110995 (.756087)	1.149865 (.7553225)
N	155	155	155	155

145. 2015 CGCC SURVEY, *supra* note 70; 2016 CGCC SURVEY, *supra* note 144.146. 2015 CGCC SURVEY, *supra* note 70; 2016 CGCC SURVEY, *supra* note 144.

Note: significance level: *** $p < 1\%$; ** $p < 5\%$; * $p < 10\%$.

I use logistic regressions to test the possible association between Chinese government ownership and U.S. tax avoidance. The results, as shown above in TABLE 4, are mixed. In models 1 and 3, the state ownership dummy is significant at the ten percent level and the coefficient is positive. In other words, Chinese investors with significant state ownership are more likely than the rest to have engaged in or plan to take actions to avoid U.S. tax. The results, however, are not robust. In the other six specifications, the state ownership dummy is not significant, suggesting that Chinese investors with state ownership act like private Chinese investors in terms of avoiding U.S. tax.

The findings contribute to the emerging debate about SOEs and taxation. According to the conventional view, SOEs should be indifferent to tax because the state shareholder is also the receiver of tax revenue.¹⁴⁷ And some empirical research has substantiated the argument by showing Chinese SOEs to be less tax aggressive than non-SOEs in the domestic setting. Recently some scholars highlight the agency problem in the corporate governance of SOEs and argue that they can be as sensitive to tax as privately-owned companies.¹⁴⁸ The findings of this Subpart lend support to this argument. State-owned Chinese investors are equally, if not more, active in avoiding U.S. tax.

Among the control variables, the use of external accountants is negatively and significantly associated with tax avoidance in the United States in models 5 and 6. Those Chinese companies that relied on internal accounting staff to handle U.S. tax matters appear to be larger ones with requisite in-house tax knowledge and capacity. Thus, they are more likely to engage in tax planning to reduce U.S. taxes.

U.S. investment size is significant and positively associated with the companies' tax planning efforts, according to the results from model 8. As expected, other things held equal, Chinese companies with larger U.S. businesses tend to have both the capacity and the need to engage in tax planning. Last, the companies in 2016 are more likely to avoid U.S. tax than those in 2015. None of these results, however, are robust. Further research is necessary to draw definitive conclusions.

To recapitulate Part III, this empirical analysis of large Chinese-invested companies in the United States generates a wide variety of new insights. While recognizing that U.S. tax is more burdensome, only a small minority of the survey respondents consider U.S. tax law to be irrational. In addition, the vast majority of Chinese investors delegate their tax matters to U.S. professionals. A correlation test on the side demonstrates

147. Huizinga & Nielson, *supra* note 135, at 402.

148. Cui, *supra* note 50.

that those companies that handle tax work internally have more U.S. investments, which implies adequate in-house tax capacity. Thus, the near universal reliance on U.S. accountants and in-house professionals facilitates the investors' adaptation to the U.S. tax system, which is confirmed by relatively low rates of IRS audits and tax controversies. Additionally, though a high percentage of Chinese companies take action to minimize their U.S. tax, about half refrain from doing so.

Moreover, the force of the Chinese state's visible hand can be keenly felt in the companies' tax behavior abroad. While large Chinese investors generally appear to cope well with U.S. tax law, those controlled by the Chinese government differ from private investors in tax conflicts. The state-owned are more prone to having tax audits and disputes with the IRS. Yet they appear no less "tax savvy" in the sense that they engage in at least as much tax planning to reduce their U.S. tax as private Chinese investors. The findings of this Article provide a preliminary empirical basis for informed policymaking and implementation that takes into account the ownership structure of China-based multinational corporations.

IV. CONTRIBUTIONS AND LIMITATIONS OF THIS STUDY

Apart from filling several gaps in the literature about taxation and FDI, this study contributes to a few important debates. The finding of general tax compliance by Chinese multinational firms in the United States sheds new light on the broad debate about the institutional impacts of FDI from developing countries. Given the wide gap between the Chinese and the U.S. tax systems in operation and the complexity of the latter, one would reasonably expect Chinese investors to exhibit systemic noncompliance. The finding that Chinese companies have adapted to the U.S. tax law portends well for compliance in other regulatory areas that tend to be much less intricate.

Moreover, the findings augur well not only for sizable Chinese outward investors, but also for investors from other developing countries with regulatory regimes more akin to that of the United States. In other words, the ability to thrive in a poor regulatory environment may not seriously hinder the ability of emerging market multinationals to effectively adapt to sophisticated, law-based regulatory systems in developed countries.

In addition, the study reveals a nexus between a foreign investor's ownership structure and its compliance with U.S. tax law. The finding contributes to the ongoing debate about Chinese SOEs and their international expansion. Though some scholars argue that the Chinese SOEs, having successfully commercialized, act in ways similar to private

Chinese companies,¹⁴⁹ the regression results in this study indicate significant lingering differences between the two.

Furthermore, the research finding of broad reliance by Chinese investors on U.S. professionals in their day-to-day compliance with U.S. tax law has important policy implications. For the U.S. service providers such as lawyers and accountants who constantly have to balance their obligations to uphold the law and the code of ethics on the one hand and the professional obligation to zealously serve their clients' interest on the other, the finding suggests that they would not have to make the hard call very frequently when serving Chinese clients, who depend primarily on the professionals for information about U.S. tax avoidance and compliance. For U.S. policymakers, the Chinese investors' heavy reliance on local professionals enables their potential regulation through the intermediaries. For instance, a high profile sanction of a U.S. lawyer or accountant for unlawful conduct in serving the Chinese clients will be more effective in terms of reining in noncompliance by Chinese companies than to directly punish the firms.

As emphasized earlier, a limitation of this study is the relatively small sample size, which is a result of the fast growing but still limited pool of large Chinese companies investing in the United States. Thus, only tentative conclusions can be drawn from the test results in Part III. However, at the current pace of growth, in a few years Chinese FDI should generate a pool of companies large enough to enable more conclusive tests. As the first scholarly endeavor to investigate the tax aspects of Chinese FDI, this study covers a wide range of topics at the risk of missing some nuances.¹⁵⁰ Finally, as is typical in most empirical scholarship, the tests in Part III uncover as many questions and puzzles as they answer. For instance, the evidence shows a heightened probability of tax audits and disputes for Chinese state-controlled firms. While this indicates that SOEs are hampered in their adjustment to the U.S. regulatory system, it falls short of pinpointing the exact internal cause. In short, this Article leaves a number of important topics for future inquiry.

CONCLUSION

Foreign direct investment plays a major role in global economic integration. In the last decade, multinational corporations from developing countries have become much more important in driving the investment flows. This new breed of multinational corporations exhibits two rather

149. ERICA DOWNS, *INSIDE CHINA, INC: CHINA DEVELOPMENT BANK'S CROSS-BORDER ENERGY DEALS* 2–5 (John L. Thornton China Ctr. at Brookings Inst. Monograph Series 2011); EDWARD S. STEINFELD, *PLAYING OUR GAME: WHY CHINA'S RISE DOESN'T THREATEN THE WEST* 265 (2010).

150. Many factors have been shown to bear on tax evasion behavior. *See, e.g.*, John R. Graham et al., *Incentives for Tax Planning and Avoidance: Evidence from the Field*, 89 ACCT. REV. 991 (2014).

unique features: they prosper in “tough” institutional environments and they function well with the state. When these firms invest abroad, important new issues about their impact on host country institutions inevitably emerge. For instance, will the multinational companies, having thrived in poor regulatory environments, export legal and regulatory noncompliance? This Article offers some preliminary answers by empirically investigating Chinese multinational companies in the U.S. tax system.

The study finds that the Chinese companies consider their U.S. tax more burdensome than Chinese tax, yet they hold a positive view about the overall U.S. tax law. At the same time, the firms rely heavily on local professionals to deal with U.S. tax matters and appear to comply with the U.S. tax law. Moreover, many Chinese companies refrain from engaging in tax avoidance to reduce their U.S. tax liability. In short, Chinese multinational companies in the United States have successfully adapted to the complex, law-based U.S. tax system. The empirical findings also bode well for broad compliance by emerging market multinationals that grapple with complex host country institutions.

However, not all Chinese companies in the United States are the same in terms of their tax compliance behavior. The structured regression analysis explores, in two areas central to tax compliance, whether the variations are associated with the investors’ Chinese government ownership. Government-owned Chinese firms encounter more challenges than their large privately-owned counterparts in coping with the complex and law-based U.S. tax system, as evidenced by a higher probability for Chinese government-owned companies in the United States to experience tax audits or disputes with the IRS. Meanwhile, the state-invested companies are no less likely to take actions to avoid U.S. tax.

U.S. regulators should take these ownership effects into account when attempting to enhance the compliance of emerging market investors with U.S. law. Finally, given the investors’ broad reliance on professional services, policymakers and enforcement agencies may consider regulating emerging market investors through service providers such as CPAs and lawyers. The findings of this study also contribute to several other important debates such as the taxation of SOEs.