

China Tax Alert

Issue 30, November 2017

US House of Representatives pass landmark tax reform bill

Regulations discussed in this issue:

- H.R. 1, the "Tax Cuts and Jobs Act", passed by the US House of Representatives on 16 November 2017 (House Tax Bill)
- Modified Senate Tax Reform Bill, prepared by the Chairman of the Senate Committee on Finance and released on 14 November 2017
- KPMG's analysis on House tax reform bill (H.R. 1), released on 16 November 2017

Click [here](#) to read the full report.

On 16 November 2017 the United States ('US') House of Representatives passed a landmark tax reform bill by a vote of 227-205. The passing of the House Tax Bill proposes a sweeping overhaul of the US tax system, the most significant changes since 1986, but is by no means the end of the process. It is now further required that the US Senate pass their own bill, that the House and Senate bills are aligned through negotiation and passed in identical form by both bodies, and that the US President signs the bill into law. Many hurdles lie in the way of making the tax reforms law, but the Trump Administration still aim to do this by Christmas 2017.

From a China perspective, the most relevant changes are those made to the US corporate tax ('CT') cross-border provisions. These could have a significant impact both on Chinese investors into the US, and on the competitiveness of Chinese multinational enterprises (MNEs) vis-a-vis their US headquartered counterparts. The planned US CT changes also feed into the wider global discussion on the shape of the future international tax rules applying to all countries, and so also impacts indirectly on China's own tax policy choices. Highlights of the international tax rule changes are set out in this alert.

US House Tax Bill main changes

The House Tax Bill provisions may be segmented into individual tax, business tax and international tax changes – we note those of potential China interest.

Individual and business tax changes

- The federal CT rate is lowered from 35% to 20%, bringing it below the OECD average. The change would be effective from January 2018.
- A revised, but complex, new set of rules for 'pass-through' businesses (i.e. sole traders, S-Corps, LLCs, partnerships) is introduced. This provides a competitive marginal 25% rate for 'qualified business income', in the place of current personal income tax (PIT) rates up to 39.6%.

- 100% expensing of capital asset investment is allowed in the period 2017-2022, though real estate assets are excluded.
- A limitation on interest expense deductions caps these at 30% of earnings before interest, tax, depreciation, and amortization (EBITDA). This rule draws on OECD BEPS Action 4. The existing earnings stripping rules are abolished. There are exemptions for small firms and real estate businesses.
- Carry forward net operating losses (NOLs) are limited to offset 90% of taxable income in any year, and loss carry backs are substantially abolished.
- A new 3 year holding period for preferential carried interest treatment.
- PIT rates and bands are reformed, many PIT/CT special deductions/credits are abolished, and Alternative Minimum Tax and Estate Duty are scrapped.

International tax rule changes

Major changes are made to both how US MNEs are taxed on their foreign operations and how foreign companies are taxed on US activities.

- A 100% CT exemption is provided to US companies on their dividends from foreign subsidiaries (10% equity holding required). Historic accumulated earnings in foreign subsidiaries are subject to a one-off tax on a deemed repatriation. This applies at 14% on cash and at 7% on illiquid assets.
- Expanded controlled foreign corporation ('CFC') rules subject the bulk of the profits of overseas subsidiaries of US MNEs (so-called 'foreign high returns') to a 10% current year tax. A US foreign tax credit is provided for 80% of the foreign tax applied to subsidiary income, meaning that no further US tax should apply as long as the foreign effective tax rate ('ETR') is at least 12.5%.
- A highly novel rule subjects outbound payments by US companies to foreign related parties to a 20% excise tax. This affects outbound payments by groups preparing consolidated financial statements, where the payments by US group members exceed USD100m annually. The rule applies to payments which are includible in cost of goods sold or in the basis for depreciable assets. There are exclusions for intra-group services paid for at cost, interest and commodity payments, and payments subject to full 30% withholding tax. However, the foreign company can instead make an election to recognize a deemed permanent establishment ('PE') in the US. This would then be taxed on a profit margin reflecting the profitability of the foreign operations of the relevant group product line, as per the global financial statements. There is a foreign tax credit of 80% of the foreign tax.
- A worldwide debt cap interest limitation rule, also drawn from BEPS Action 4, is introduced. This limits net interest expense deductions to the extent that the US company share of an international group's global net interest expense exceeds 110% of the US share of the group's EBITDA.

KPMG observations

The House Tax Bill contains many innovations which break with historic US tax practices. The changes move the US towards a territorial system, with dividend the participation exemption. However, conversely, they also move the US toward a 'true' worldwide system, with the tax on 'foreign high returns'. The outbound payments rule introduces 'destination based' taxing rights, and may impact on the OECD digital economy tax work at global level. This, together with the interest rules, would impact Chinese enterprise operations in the US, and raise tax treaty compatibility issues. Chinese tax policymakers will also be watching developments closely, and may consider policy adjustments to maintain China business competitiveness. The Senate bill differs on many points, with a different base erosion rule and a special IP income rule –closely monitoring is needed to see how the bills are reconciled.

For any enquiries, please send to our public mailbox: taxenquiry@kpmg.com or contact our partners/directors in each China/HK offices.

Khoonming Ho

Head of Tax,
KPMG Asia Pacific
Tel. +86 (10) 8508 7082
khoonming.ho@kpmg.com

Lewis Lu

Head of Tax,
KPMG China
Tel. +86 (21) 2212 3421
lewis.lu@kpmg.com

Beijing/Shenyang/Qingdao Vincent Pang

Tel. +86 (532) 8907 1728
vincent.pang@kpmg.com

Tianjin

Eric Zhou
Tel. +86 (10) 8508 7610
ec.zhou@kpmg.com

Shanghai/Nanjing/Chengdu

Anthony Chau
Tel. +86 (21) 2212 3206
anthony.chau@kpmg.com

Hangzhou

John Wang
Tel. +86 (571) 2803 8088
john.wang@kpmg.com

Guangzhou

Lilly Li
Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Fuzhou/Xiamen

Maria Mei
Tel. +86 (592) 2150 807
maria.mei@kpmg.com

Shenzhen

Eileen Sun
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Hong Kong

Karmen Yeung
Tel. +852 2143 8753
karmen.yeung@kpmg.com

Northern China

Vincent Pang

Head of Tax,
Northern Region
Tel. +86 (10) 8508 7516
+86 (532) 8907 1728
vincent.pang@kpmg.com

Cheng Chi

Tel. +86 (10) 8508 7606
cheng.chi@kpmg.com

Conrad TURLEY

Tel. +86 (10) 8508 7513
conrad.turley@kpmg.com

Milano Fang

Tel. +86 (532) 8907 1724
milano.fang@kpmg.com

Tony Feng

Tel. +86 (10) 8508 7531
tony.feng@kpmg.com

Flora Fan

Tel. +86 (10) 8508 7611
flora.fan@kpmg.com

John Gu

Tel. +86 (10) 8508 7095
john.gu@kpmg.com

Rachel Guan

Tel. +86 (10) 8508 7613
rachel.guan@kpmg.com

Helen Han

Tel. +86 (10) 8508 7627
h.han@kpmg.com

Michael Wong

Tel. +86 (10) 8508 7085
michael.wong@kpmg.com

Josephine Jiang

Tel. +86 (10) 8508 7511
josephine.jiang@kpmg.com

Henry Kim

Tel. +86 (10) 8508 5000
henry.kim@kpmg.com

David Ling

Tel. +86 (10) 8508 7083
david.ling@kpmg.com

Li Li

Tel. +86 (10) 8508 7537
li.li@kpmg.com

Lisa Li

Tel. +86 (10) 8508 7638
lisa.h.li@kpmg.com

Thomas Li

Tel. +86 (10) 8508 7574
thomas.li@kpmg.com

Larry Li

Tel. +86 (10) 8508 7658
larry.y.li@kpmg.com

Lucia Liu

Tel. +86 (10) 8508 7570
lucia.jj.liu@kpmg.com

Alan O'Connor

Tel. +86 (10) 8508 7521
alan.oconnor@kpmg.com

Shirley Shen

Tel. +86 (10) 8508 7586
yinghua.shen@kpmg.com

Joseph Tam

Tel. +86 (10) 8508 7605
laiyi.tam@kpmg.com

Joyce Tan

Tel. +86 (10) 8508 7666
joyce.tan@kpmg.com

Cynthia Xie

Tel. +86 (10) 8508 7543
cynthia.py.xie@kpmg.com

Christopher Xing

Tel. +86 (10) 8508 7072
christopher.xing@kpmg.com

Irene Yan

Tel. +86 (10) 8508 7508
irene.yan@kpmg.com

Adams Yuan

Tel. +86 (10) 8508 7596
adams.yuan@kpmg.com

Jessie Zhang

Tel. +86 (10) 8508 7625
jessie.j.zhang@kpmg.com

Sheila Zhang

Tel. +86 (10) 8508 7507
sheila.zhang@kpmg.com

Tiansheng Zhang

Tel. +86 (10) 8508 7526
tiansheng.zhang@kpmg.com

Tracy Zhang

Tel. +86 (10) 8508 7509
tracy.h.zhang@kpmg.com

Eric Zhou

Tel. +86 (10) 8508 7610
ec.zhou@kpmg.com

Central China

Anthony Chau

Head of Tax,
Eastern & Western Region
Tel. +86 (21) 2212 3206
anthony.chau@kpmg.com

Yasuhiko Otani

Tel. +86 (21) 2212 3360
yasuhiko.otani@kpmg.com

Johnny Deng

Tel. +86 (21) 2212 3457
johnny.deng@kpmg.com

Cheng Dong

Tel. +86 (21) 2212 3410
cheng.dong@kpmg.com

Marianne Dong

Tel. +86 (21) 2212 3436
marianne.dong@kpmg.com

Chris Ge

Tel. +86 (21) 2212 3083
chris.ge@kpmg.com

Chris Ho

Tel. +86 (21) 2212 3406
chris.ho@kpmg.com

Henry Wong

Tel. +86 (21) 2212 3380
henry.wong@kpmg.com

Jason Jiang

Tel. +86 (21) 2212 3527
jason.tj.jiang@kpmg.com

Flame Jin

Tel. +86 (21) 2212 3420
flame.jin@kpmg.com

Sunny Leung

Tel. +86 (21) 2212 3488
sunny.leung@kpmg.com

Michael Li

Tel. +86 (21) 2212 3463
michael.y.li@kpmg.com

Karen Lin

Tel. +86 (21) 2212 4169
karen.w.lin@kpmg.com

Benjamin Lu

Tel. +86 (21) 2212 3462
benjamin.lu@kpmg.com

Christopher Mak

Tel. +86 (21) 2212 3409
christopher.mak@kpmg.com

Henry Ngai

Tel. +86 (21) 2212 3411
henry.ngai@kpmg.com

Naoko Hirasawa

Tel. +86 (21) 2212 3098
naoko.hirasawa@kpmg.com

Ruqiang Pan

Tel. +86 (21) 2212 3118
ruqiang.pan@kpmg.com

Amy Rao

Tel. +86 (21) 2212 3208
amy.rao@kpmg.com

Wayne Tan

Tel. +86 (28) 8673 3915
wayne.tan@kpmg.com

Tanya Tang

Tel. +86 (25) 8691 2850
tanya.tang@kpmg.com

Rachel Tao

Tel. +86 (21) 2212 3473
rachel.tao@kpmg.com

Janet Wang

Tel. +86 (21) 2212 3302
janet.z.wang@kpmg.com

John Wang

Tel. +86 (571) 2803 8088
john.wang@kpmg.com

Mimi Wang

Tel. +86 (21) 2212 3250
mimi.wang@kpmg.com

Jennifer Weng

Tel. +86 (21) 2212 3431
jennifer.weng@kpmg.com

Grace Xie

Tel. +86 (21) 2212 3422
grace.xie@kpmg.com

Bruce Xu

Tel. +86 (21) 2212 3396
bruce.xu@kpmg.com

Jie Xu

Tel. +86 (21) 2212 3678
jie.xu@kpmg.com

Robert Xu

Tel. +86 (21) 2212 3124
robert.xu@kpmg.com

Yang Yang

Tel. +86 (21) 2212 3372
yang.yang@kpmg.com

Jason Yu

Tel. +86 (21) 2212 3316
jjm.yu@kpmg.com

William Zhang

Tel. +86 (21) 2212 3415
william.zhang@kpmg.com

Hanson Zhou

Tel. +86 (21) 2212 3318
hanson.zhou@kpmg.com

Michelle Zhou

Tel. +86 (21) 2212 3458
nichelle.b.zhou@kpmg.com

Eric Zhang

Tel. +86 (21) 2212 3398
eric.zhang@kpmg.com

Kevin Zhu

Tel. +86 (21) 2212 3346
kevin.x.zhu@kpmg.com

Southern China

Lilly Li

Head of Tax,
Southern Region
Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Penny Chen

Tel. +1 (408) 367 6086
penny.chen@kpmg.com

Vivian Chen

Tel. +86 (755) 2547 1198
vivian.w.chen@kpmg.com

Nicole Cao

Tel. +86 (20) 3813 8619
nicole.cao@kpmg.com

Sam Fan

Tel. +86 (755) 2547 1071
sam.kh.fan@kpmg.com

Joe Fu

Tel. +86 (755) 2547 1138
joe.fu@kpmg.com

Ricky Gu

Tel. +86 (20) 3813 8620
ricky.gu@kpmg.com

Fiona He

Tel. +86 (20) 3813 8623
fiona.he@kpmg.com

Angie Ho

Tel. +86 (755) 2547 1276
angie.ho@kpmg.com

Aileen Jiang

Tel. +86 (755) 2547 1163
aileen.jiang@kpmg.com

Cloris Li

Tel. +86 (20) 3813 8829
cloris.li@kpmg.com

Jean Li

Tel. +86 (755) 2547 1128
jean.j.li@kpmg.com

Sisi Li

Tel. +86 (20) 3813 8887
sisi.li@kpmg.com

Mabel Li

Tel. +86 (755) 2547 1164
mabel.li@kpmg.com

Kelly Liao

Tel. +86 (20) 3813 8668
kelly.liao@kpmg.com

Patrick Lu

Tel. +86 (755) 2547 1187