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The Tax Structure of the People’s Republic of China

RICHARD D. POMP* AND STANLEY S. SURREY**

This article is an outgrowth of a month-long seminar on various aspects of taxation held in the People’s Republic of China during the summer of 1979.1 The seminar was conducted under the auspices of the Harvard Law School International Tax Program.2 More than 120 Chinese officials, drawn from the Ministry of Finance and other ministries and agencies concerned with foreign investment, participated in the seminar. Also attending were academicians and managers of various cooperatives, collectives, and State enterprises.3

** Jeremiah Smith Professor, Harvard Law School.
1. The authors express their appreciation to Professor Oliver Oldman for his perceptive comments on a draft of this article. An earlier version of this article was prepared for the Practising Law Institute's program, “A New Look at Legal Aspects of Doing Business With China” (New York City, Dec. 12-14, 1979, and San Francisco, Jan. 14-16, 1980). See Pomp & Surrey, Taxation in the People’s Republic of China, in A NEW LOOK AT LEGAL ASPECTS OF DOING BUSINESS WITH CHINA: DEVELOPMENTS A YEAR AFTER RECOGNITION 353 (H. Holtzmann & W. Surrey eds. 1979)[hereinafter cited as DOING BUSINESS WITH CHINA].
2. Professor Jerome A. Cohen, Director of East Asian Legal Studies, Harvard Law School, was instrumental in arranging the seminar. In addition to the authors, the following professors participated in the seminar: Harvey P. Dale, New York University School of Law; Robert Hellawell, Director of the Center for Law and Economic Studies, Columbia University School of Law; and Oliver Oldman, Director of the International Tax Program, Harvard University Law School. Financial assistance was provided by the Ford Foundation.
3. The seminar was conducted six days per week, Monday through Saturday. The morning sessions consisted of four hours of lectures to the entire group. During the afternoons, each author met with a group of approximately ten officials for two or three hours of discussions.

Before the start of the seminar, the Chinese received a set of English-language teaching materials. The Chinese translated these materials and printed more than 7000 copies in the form of two monographs. The Chinese participants assembled two weeks in advance of the seminar in order to study the materials.
The description of the Chinese domestic tax system presented in this article reflects the understanding gained by the authors during their brief visit, and at least one caveat is in order. The nature and the limited amount of foreign investment in China have made it unnecessary in the past for the Chinese to consider the applicability of their domestic tax laws to foreigners. The increase in foreign investment which is expected in response to recent developments, especially the newly enacted Joint Venture Law, will require some changes in the existing tax structure, and the Standing Committee of the National People's Congress has declared that taxation will be included in the extensive legislative revisions under way at present. Indeed, the seminar was organized in part so that Chinese policy makers could be exposed to the range of options, drawn in part from existing legislation in various countries, for the taxation of foreigners and foreign investment. Legislative developments, therefore, are likely to overtake the information presented in this article.

Although revisions can be expected, an examination of the ex-


5. In addition, because neither author speaks or reads Chinese, they were forced to rely on interpreters in their discussions with Chinese officials. This procedure inevitably leads to some communication problems when technical issues are involved, even with the best of interpreters.

6. The Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment, adopted by the Second Session of the Fifth National People's Congress on July 1, 1979, translated in DOING BUSINESS WITH CHINA, supra note 1, at 507 [hereinafter cited as Joint Venture Law]. A joint venture must take the form of a limited liability company. Id. Other forms of investment, such as partnerships, are not covered by the Joint Venture Law but will be the subject of future legislation. See generally Cohen, Huang, & Nee, China's New Joint Venture in DOING BUSINESS WITH CHINA, supra note 1, at 195; Klingenberg & Pattison, Joint Ventures in the People's Republic of China: The New Legal Environment, 19 VA. J. INT'L L. 807 (1979). The Joint Venture Law allows the parties to agree on the duration of the joint venture. Joint Venture Law, supra, art. 12. A joint venture corporation that is limited in time raises an issue about its characterization for U.S. tax purposes. Such a corporation may be characterized as a partnership and taxed accordingly. See D. Tillinghast, TAX ASPECTS OF INTERNATIONAL TRANSACTIONS 239-44 (1978).
isting Chinese tax system is nonetheless valuable. Its present structure may suggest the shape and flavor of forthcoming legislation. At the least, some insight is provided into the concepts and approaches that are familiar to the Chinese. Moreover, although increased foreign investment will lead to new taxes, the Chinese also might conclude that certain features of their present system could be applied to foreigners without major modifications.

At least nine taxes exist in China:7 (1) the industrial and commercial income tax, (2) the consolidated industrial and commercial tax, (3) the real estate tax,8 (4) the agricultural tax,9 (5) the

7. The list contains all the major taxes of which the authors are aware. Other, less significant taxes may exist, of course. The list corresponds to those government levies which are traditionally classified in the West as taxes. Other commentators might well expand the list to reflect transactions and activities that are unique to a noncapitalist economy. Eckstein, for example, refers to the compulsory sale of certain agricultural products to the Chinese government at fixed prices as involving a "quasi-tax." A. ECKSTEIN, CHINA'S ECONOMIC REVOLUTION 119 (1977). Determining the amount of this quasi-tax is difficult, however, because the differential between the market price and the fixed price at which a product is sold to the government probably overstates the tax element. "Since the 'free market' is small and all of the repressed, excess demand tends to be concentrated in this narrow market, prices in it were almost certainly above the levels at which they would have been if there had been no fixed purchase arrangements." Id. See also P. JONAS, TAXATION OF MULTINATIONALS IN COMMUNIST COUNTRIES 5-10 (1978). China, however, does not view these purchases as a form of taxation. See Ting, supra note 4.

State-owned enterprises pose another definitional problem. Because State enterprises turn all of their profits over to the State, which later determines their need for reinvestment funds, one might characterize such enterprises as being subject to a special income tax imposed at a 100% rate. China, however, does not view State enterprises in this manner. Profits from State enterprises are not classified as taxes. In fact, such enterprises are specifically exempt from income taxation. See text accompanying notes 17-18 infra.

8. The real estate tax is levied only in the cities and is a source of local revenue. The rate of the tax varies from one city to another. Land is taxed to the owner at approximately 1.2% of the value of the land. Land appears to be valued on an historical basis. With few exceptions, all land is owned by the State. The tax thus serves to transfer revenue from the State to the cities.

Buildings and structures are taxed differently, depending on whether they are rented or owner-occupied. In the case of a building or structure that is rented, the rate of tax to the owner is approximately 18% of its rental value. Most rental property is owned by either the State or a State enterprise.

Owner-occupied buildings are subject to a tax of approximately 1.3% of the fair market value of the building. Although individuals, State enterprises, cooperatives, and collectives are free to buy and sell buildings and structures, no active market seems to exist, and it is unclear how fair market value is determined.

Presumably, the assessed value of a site for purposes of the real estate tax will have little bearing on the determination of its value for purposes of the Joint Venture Law. Article 5 of the Joint Venture Law provides that the investment contributed by a Chinese participant may include the right to the use of a site provided for the joint venture. If the use of a site is not part of the Chinese participant's investment, then the joint venture will pay the Chinese government for the use of the site. Joint Venture Law, supra note 6, art. 5. Valuation of a site for purposes of article 5 is unlikely to be governed by the site's assessed value under the real estate tax.
vehicle license tax,\(^9\) (6) the slaughter tax,\(^1\) (7) the salt tax,\(^2\) (8)

For a description of the real estate tax from 1950 to 1959, see G. Ecklund, supra note 4, at 33. See also A. Chekhutov, supra note 4, at 63, 135.

9. The basic format of the agricultural tax was established in 1958 when it was approved by the Standing Committee of the National People's Congress. By 1958, most rural families were members of farm cooperatives. In late 1958, these cooperatives were merged into large communes, and in 1959, the production brigade, a subdivision of the commune, was designated as the taxpaying unit under the agricultural tax. The only individuals who were subject to the agricultural tax as individuals were those few persons who remained outside the cooperatives and those cooperative members who still owned land privately. See G. Ecklund, supra note 4, at 16.

The rate of the tax is set at 15.5% of the normal, average 1958 harvest output, which is defined as the crop harvested from a certain category of land under natural conditions by the usual methods of labor, organization, and plantings. Since average harvests have increased since 1958, the effective rate of tax is currently between four and six percent. By basing its rate on 1958 outputs, the tax is intended to provide an incentive to increase production. The rate can be reduced if a drought or a flood occurs. The tax is collected in kind by the local government and sold to certain State agencies; the sales proceeds are then transmitted to the national government.

During the Chinese Civil War, ending in 1949, agricultural taxes were collected according to roughly estimated quotas. In areas that the new government acquired after 1949, progressive agricultural taxes were imposed on gross income derived from the land. In areas where the government had completed its policy of land redistribution, e.g., North China and Manchuria, proportional rates, rather than progressive rates, were levied. Id. at 11-12.

Between 1950 and 1958, the agricultural tax was levied on the “set yield” of the land. The set yield was determined by committees composed of persons designated by local government units. These committees computed the set yield by taking into account the type of soil, the extent of irrigation, and the use of fertilizers. Once determined, the set yield could remain the same for several years. In 1957, the national set yield was reported to be 69% of actual production. In certain individual cases, however, the set yield was reported to be greater than actual output. Id. at 12.

The actual operation of the pre-1958 agricultural tax was quite complex. In general, the agricultural tax was designed to encourage production of certain crops, e.g., cotton, tobacco, and hemp, to increase production and cultivation generally, to redistribute land from landlords to peasants, and to achieve a more equitable distribution of income among persons farming their own land. For a more complete discussion, see id. at 12-16; Chao Kuo-chun, supra note 4, at 188-93; A. Chekhutov, supra note 4, at 80-85, 147-67; A. Donnithorne, supra note 4, at 337-64.

The pre-1958 tax on set yield also was intended to provide farmers with an incentive to develop their land and increase production without becoming subject to higher taxes. As an incentive to increase the amount of land under cultivation, newly-plowed acreage was exempt from the tax for a period of from three to five years. See G. Ecklund, supra note 4, at 12-13. Tax reductions were also provided under the pre-1958 agricultural tax in case of crop losses caused by natural disasters. A local committee determined the extent of loss, and the tax due was reduced accordingly.

10. The vehicle license tax applies to all vehicles, but some cities exempt nonmotorized vehicles, such as carts and bicycles. Beijing, for example, exempts bicycles owned by Chinese. The tax is paid once a year to the local government, with proceeds earmarked for road construction. The tax does not appear to be levied in the rural areas.

The amount of the tax varies. In the case of motorized vehicles, which generally are not owned by individuals, the tax is based on tonnage. For other vehicles, the tax is a fixed
the foreign shipping tax,\textsuperscript{13} and (9) customs duties.\textsuperscript{14} Of these nine, the income tax and the consolidated industrial and commercial tax are of the most interest to foreigners and, therefore, form the heart of this paper. The authors have benefited from studying unofficial English-language translations of both these tax laws and the regulations promulgated under the consolidated industrial and commercial tax. Although extensive income tax regulations apparently exist, they were not available for study.

\section*{I. The Industrial and Commercial Income Tax}

The Industrial and Commercial Income Tax Act (ICITA)\textsuperscript{15} was adopted in 1950 and has not been changed since 1958. The ICITA consists of twenty-nine broadly phrased articles and a schedule of income tax brackets and rates. The following sections of this article describe the taxpayers and taxable activities, tax base, tax rates, payment and collection procedures, violations and penalties, and amount.

11. The slaughter tax is levied at the time of slaughter at a fixed amount per animal. The amount of tax, which is different for each animal, is based on the animal's fair market value. The tax is paid to the local government by the owner of the animal. An exemption is provided for the slaughter of the animals during specific holidays. For a description of the slaughter tax from 1950 to 1959, see G. Ecklund, supra note 4, at 32. See also A. Chekhutov, supra note 4, at 61, 135.

12. The amount of the salt tax, which is levied on a tonnage basis, varies from region to region. The tax ranges from under 100 yuan per ton to 160 yuan per ton and is paid by the producer. For a description of the salt tax during 1950-59, see G. Ecklund, supra note 4, at 23. Historically, the salt tax has been one of the easiest of all Chinese taxes to administer and has provided a stable source of revenue. Id. at 24. See also A. Donnithorne, supra note 4, at 380; T. Miyashita, The Currency and Financial System of Mainland China 39-40 (1966).

13. The foreign shipping tax is a substitute for the industrial and commercial income tax and the consolidated industrial and commercial tax. The tax is levied on the revenue from freight originating in China and on the income from freight and passengers loaded in China. The rate of tax is 3\%, but local governments can levy a supplemental tax of .03\%, bringing the total rate to 3.03\%. This rate is quite high by worldwide standards and is often reduced as part of a bilateral agreement.

14. The authors did not discuss the customs duties with Chinese officials in detail, but they understand that an exemption is provided for all raw materials, supplementary materials, parts, and equipment imported for the purpose of processing or assembly. For a description of customs duties during 1950-59, see G. Ecklund, supra note 4, at 29-31. In 1966, Donnithorne claimed that customs duties were used for bargaining purposes during foreign trade negotiations. A. Donnithorne, supra note 4, at 380.

implications for foreign business of the ICITA.

A. Taxpayers and Taxable Activities

All industrial and commercial profit-making enterprises within the boundaries of the People's Republic of China, whether State-owned, privately owned, part State-owned and part privately owned, or cooperative are subject to the income tax. The ICITA classifies industrial and commercial enterprises, according to the manner in which they do business, as either permanent industrial and commercial enterprises, temporary commercial enterprises, or street peddlers. The Ministry of Finance may prescribe separate measures for taxing temporary commercial enterprises and street peddlers. The ICITA provides exemptions from income taxation for poor craftsmen, State enterprises, and other entities approved by the Ministry of Finance.

State enterprises are exempt from taxation, presumably because all of the profits of these enterprises are paid to the State in any event. The profits of a State enterprise are calculated, however, by following the principles and rules contained in the ICITA. It is not clear whether a State enterprise automatically receives a share of its profits for reinvestment.

Though the ICITA refers to street peddlers and poor craftsmen, in practice no individual, even street peddlers and poor craftsmen, is subject to the income tax. The only enterprises actually taxed on income are the collectives and cooperatives, which are not

16. *Id.* art. 1. Donnithorne claims that joint State-private concerns do not pay the income tax, but turn all of their profits over to the State, as State enterprises do. A. DONNITHORNE, *supra* note 4, at 378.
17. ICITA, *supra* note 15, art. 2.
18. *Id.* art. 4. The authors received no information about these separate measures.
19. *Id.* art. 8.
20. A few State enterprises are so small that they are "outside the State budget." These enterprises do not pay their profits to the State but instead are subject to the income tax. *See, e.g., id.* arts. 4, 8.
22. Ecklund writes that an individual income tax was proposed in 1950, but had not been implemented by 1959. G. ECKLUND, *supra* note 4, at 60. *See also* CHAO KUO-ChUN, *supra* note 4, at 184. In 1964, Premier Chou En-lai stated that the current government had never levied a personal income tax. A. DONNITHORNE, *supra* note 4, at 379. The Nationalist Government levied an income tax on salaries and business profits, but administrative difficulties prevented it from generating much revenue. *Id.* at 378.
23. Donnithorne writes that in 1958, rural handicraft communes were no longer subject to the income tax. Nonrural handicraft cooperatives apparently remained liable for the tax. A. DONNITHORNE, *supra* note 4, at 378-79. Donnithorne also reports that enterprises operated by production teams were exempt from the tax, though this exemption may have been limited
owned by the State and thus are not exempt as State enterprises. Presumably, an individual is not subject to the income tax because, at present, he cannot engage in substantial business activity as an individual.\textsuperscript{24} Only State enterprises, cooperatives, or collectives can engage in substantial business activities. In China, the major sources of income for an individual—wages, a pension, or interest\textsuperscript{25} from a savings account—are not income received from the operation of an industrial or commercial enterprise and hence are not taxable.\textsuperscript{26} Although at present this treatment appears to apply also to foreigners working in China, a personal income tax on wages or salaries can be expected.\textsuperscript{27}

Whether all income received by individuals is exempt from the income tax is problematical. For example, "some old capitalists" apparently own private property, which they are free to rent. Other persons may receive rental income from letting rooms to boarders. It is unclear whether an individual can be classified as a commercial enterprise in such cases. Although situations involving substantial amounts of rental income might be uncommon, the basic question whether individuals can be classified as commercial enter-

\textsuperscript{24} According to one report, all licenses allowing individuals to operate private businesses were withdrawn in 1966, though some persons have continued to operate such businesses clandestinely. Wall St. J., Aug. 15, 1979, at 12, col. 3. Licenses again are being issued. See text accompanying note 28 infra.

\textsuperscript{25} From 1950 to 1959, interest from bank deposits, bonds, securities, and loans to employees was taxed at a flat rate of five percent. Excluded was interest from funds invested in industrial development, interest on bank loans, interest receipts of less than five yuan, and interest received by certain nonprofit organizations. Payors of taxable interest withheld and remitted the tax to the government. Payors were entitled to retain one percent of the withheld tax for their own use. The tax on interest was abolished in 1959. In order to compensate for the loss of tax revenue, the interest rate paid by the People's Bank on individual savings accounts was reduced. See G. Ecklund, supra note 4, at 32. Chao Kuo-chun indicates that revenues from this tax went to local governments. Chao Kuo-chun, supra note 4, at 185.

\textsuperscript{26} At an earlier time, dividends might have been another source of income for individuals. In 1955, the government began a large-scale nationalization drive to convert all private enterprises into joint public-private corporations whose stock would be held both by individuals and by the government. Dividends paid on the shares held by individuals were not to exceed certain fixed amounts. See A. Eckstein, supra note 7, at 76. Donnithorne states that in the mid-1960's, approximately 250,000 former capitalists were receiving dividends. These payments were supposed to terminate in 1962, but were extended for three more years, after which time their continuance was to have been reconsidered. A. Donnithorne, supra note 4, at 147-48. Eckstein speculates that these payments were discontinued during the Cultural Revolution, when the joint public-private enterprise probably disappeared. A. Eckstein, supra note 7, at 76.

\textsuperscript{27} See text at notes 41-43 infra.
prises will become more critical in the near future, since the Chinese are planning to license urban peddlers, small shopkeepers, repairmen, door-to-door salesmen, and similar entrepreneurs. Apparently, these persons will conduct their businesses as individuals and not as collectives or cooperatives.28 Whether these persons are subject to the existing income tax, therefore, will depend on whether they are classified as commercial enterprises.

B. Tax Base

The ICITA states only that “income” means the amount of gross income for each business year or for the actual period during which business is done, less costs, expenses, and losses.29 From conversations with tax officials and the examination of tax returns, the authors obtained the following additional information. First, there is no concept of capital gains. A gain or a loss on the sale or exchange of a “capital asset” is treated as ordinary income or as an ordinary loss. Second, the government determines the rate of depreciation applicable to various categories of assets. These categories are broad, e.g., “buildings” or “machines,” and few in number. The government determines the useful life of depreciable assets and publishes a set of depreciation rates based on straight-line depreciation. Third, small cooperatives apparently use a first-in-first-out (FIFO) approach to inventory accounting. Large cooperatives use instead a method described as a “weighted average price.” The last-in-first-out (LIFO) approach is not used. Fourth, with respect to other deductions, all costs of production, including the consolidated tax, administrative expenses, and all other necessary expenses are deductible.

C. Tax Rates

Under the ICITA, income is subject to a progressive set of tax rates ranging from 5.75% (levied on annual incomes of less than 300 yuan) to 34.5% (levied on annual incomes of 10,000 yuan or more).30 There are twenty-one tax brackets, varying in width from

28. Canton’s revolutionary committee may have approved the issuance of as many as 15,000 licenses. Wall St. J., Aug. 15, 1979, at 12, col. 5. A recent report indicates, however, that these businesses will be operated as collectives. N.Y. Times, Oct. 8, 1979, at A1, col. 1.
29. ICITA, supra note 15, art. 18. The business year is a calendar year. Id. art. 21.
30. ICITA, supra note 15, Schedule of Income Tax Brackets and Rates. From 1950 to 1957, a 10% to 40% reduction in the income tax was available for certain essential businesses.
100 yuan to 2,500 yuan. In addition to these basic rates, the government imposes a surtax ranging from 10% to 100%. The authors were told that the amount of the surtax varies from region to region and from enterprise to enterprise. Other persons, however, have been told that the surtax is imposed uniformly throughout China at a rate of sixty percent.

D. Payment and Collection Procedures

The taxable period for the income tax is the calendar year. Payments of estimated income tax are made quarterly, and final returns are due no later than March of the following year.

E. Violations and Penalties

The ICITA provides for a penalty payment of .5% per day on the amount of tax in arrears. The Minister of Finance may, if necessary, increase or reduce the penalty. In the case of tax evasion, a penalty of up to ten times the tax evaded may be imposed. Serious cases of tax evasion may be referred to the courts. The ICITA imposes a duty on all persons to report cases of tax evasion, with the added incentive that informers are entitled to a reward of twenty to thirty percent of the penalty imposed.

31. As of February 1980, one yuan equaled U.S. $0.62.
32. In 1958, the government introduced a special surtax also ranging from 10% to 100%. The surtax applies to “capitalist industrial and commercial enterprises . . . . Those enterprises which receive especially large profits may be subject to a higher surtax.” Rules for Improving the System of Taxation Administration, adopted by the State Council at its 75th Plenary Session on April 11, 1958, and approved by the Standing Committee of the National People’s Congress at its 97th meeting on June 5, 1958. The authors were assured, however, that this special surtax will not apply to the profits of a joint venture.
33. Wei Min claims that different rates of income tax are applied to different types of collectives “according to their position and role in the national economy.” Wei Min, supra note 4, at 23.
34. ICITA, supra note 15, art. 21.
35. Some have been told that final returns are due by March 31, but the law states only no later than March. Id.
36. Id. art. 27.
37. Id.
38. Id. art. 25.
39. Id.
40. Id. art. 26.
F. Implications for Foreign Business

The original 1950 version of the ICITA refers to privately owned enterprises and part State-owned and part privately owned enterprises. Although both forms of ownership were common for a period of time after the end of the Chinese Civil War in 1949, they are no longer. Nevertheless, the language has remained in the ICITA and would appear to subject joint ventures with foreigners to the existing income tax. The present law, however, is obviously inadequate for dealing with the problems raised by foreign investment, and a new tax code has been under consideration for some time.41 The recent Joint Venture Law clearly anticipates a joint venture income tax42 and a personal income tax,43 but neither of these taxes has been enacted yet.

The Joint Venture Law provides for a reduction of or an exemption from income tax under two different circumstances. First, “a joint venture equipped with44 up-to-date technology by world standards may apply for a reduction of or exemption from income tax for the first two to three profit-making years.”45 The requirement

41. A new tax code originally was expected sometime during the fall of 1979. The delay in drafting the new code might be attributable in part to the seminar held last summer, which may have brought to the Chinese a fuller awareness of the dimensions of the task. See text at note 2 supra. In a recent interview Rong Yiren, Chairman and President of the China International Trust and Investment Corporation, stated that a new tax law will “most probably” be established in the first half of 1980. Wall St. J., Jan. 14, 1980, at 15, col. 2.

42. Article 7 of the Joint Venture Law provides that the net profit of a joint venture shall be distributed after a joint venture income tax is paid on its gross profit pursuant to the tax laws of China and after the reserve funds, the bonus and welfare funds for the workers and staff members, and the expansion funds of the venture which are stipulated in the venture’s articles of association have been deducted. See Joint Venture Law, supra note 6.

The use of the phrase “gross profit” can be misleading. The authors were told that gross profit is computed by subtracting from gross income all business expenses. Gross profit thus corresponds to net income. The term gross profit apparently is used in article 7 to indicate before-tax profit, as distinct from the term net profit, which refers to after-tax profit. The deductions for reserve, bonus, welfare, and expansion funds are not allowed for tax purposes. See also Cohen, Huang, & Nee, supra note 6, at 224-25.

43. Article 11 of the Joint Venture Law provides that after the personal income tax is paid under the tax laws of the People’s Republic of China, wages, salaries, or other legitimate income earned by a foreign worker or staff member of a joint venture may be remitted abroad through the Bank of China in accordance with foreign exchange regulations. See Joint Venture Law, supra note 6.

44. The law is silent on whether “equipped with” implies that the technology must be contributed to the joint venture or whether it implies that the technology may be obtained through licensing.

45. Id. art 7. This provision does not refer to a “joint venture income tax,” but only to an “income tax.” In the view of many U.S. lawyers who are intimately involved with China, this discrepancy is just an example of the haste with which the Joint Venture Law was
that technology be “up-to-date by world standards” differs in wording from the provision found elsewhere in the Joint Venture Law that “technology or equipment contributed by any foreign participant as investment shall be truly advanced and appropriate to China’s needs.” Technology that is up-to-date by world standards probably was developed for capital-intensive economies and thus may be inappropriate for a labor-intensive economy such as China’s. The Chinese are aware of this problem, and a good deal of flexibility and discretion may accompany the interpretation of “up-to-date technology.”

The reduction or exemption from income tax is granted for the first two or three profit-making years, not from the start of the joint venture. This approach favors investors since it means that an initial period of start-up losses will not count against the years in which the reduction or exemption is granted. Presumably, even a loss year that occurs after the start-up period and after a profit-making year also will not count against the joint venture’s period for obtaining an exemption or a reduction. Furthermore, even though the Joint Venture Law authorizes only a two- or three-year period of exemption or reduction, Rong Yiren, Chairman and President of the China International Trust and Investment Corporation, has indicated that the period could be extended.

The second circumstance in which a reduction or an exemption from income tax may be granted involves the reinvestment of profits. A foreign participant that reinvests any part of its share of the net profit within Chinese territory may apply for the restitution of a part of the income tax paid. No minimum amount of reinvestment is specified, and the profits need not be reinvested in the same joint venture. Obviously, however, the amount and the nature of the reinvestment are likely to influence the degree to which the tax is reduced.

According to some commentators, the existence of these provisions for a reduction or an exemption from income tax implies a

drafted. Nonetheless, if the Chinese were to apply their existing income tax to joint ventures until a new joint venture income tax is enacted, the Joint Venture Law would authorize the granting of an exemption or a reduction.

46. Id. art. 5.
47. See Cohen, Huang, & Nee, supra note 6, at 223.
48. Although Taiwan is considered Chinese territory, reinvestment there is unlikely to qualify a foreign participant for a reduction or an exemption.
49. Joint Venture Law, supra note 6, art. 7.
promise of favorable consideration. The impression of the authors, however, is that the Chinese have not determined yet the extent to which these tax incentives will be granted. Initially, some foreign businessmen advised the Chinese that they ought to offer tax incentives. The Chinese also were aware of incentives used by Indonesia, South Korea, Hong Kong, and Taiwan. Like any other developing country, China is concerned that it will be unable to compete for foreign investment unless it offers incentives similar to those provided elsewhere.

More recently, however, the Chinese have learned that many observers question the efficiency and the effectiveness of tax incentives. These observers feel that decisions to invest are influenced by a wide variety of factors, such as the cost and the quality of local labor, the availability of raw materials, political and legal stability, the size of the domestic market, and the development of the country's infrastructure. In comparison to these factors, tax considerations may be relatively unimportant. The Chinese also realize that their country's strong natural attraction for investors from abroad should make the role of tax incentives less important than it is in other, smaller, countries.

No clear policy on the use of the tax incentives provided by the Joint Venture Law has emerged yet. Most of the joint venture agreements now being negotiated contain a request for complete exemption from income taxation, but China has yet to approve finally any of these agreements. If these requests for total exemption are denied, U.S. investors undoubtedly will attempt to reach agreements with the Chinese on the manner in which and the extent to which their joint ventures will be subject to income taxation. The Chinese have given assurances that should the law change, any prior agreement reached as to tax consequences will be grandfathered into the new law.

II. THE CONSOLIDATED INDUSTRIAL AND COMMERCIAL TAX

The present Consolidated Industrial and Commercial Tax Act (CICTA) was adopted in 1958. Prior to the CICTA, industry and

50. See, e.g., Cohen, Huang, & Nee, supra note 6, at 223.
51. See note 110 infra.
commerce were subject to four\textsuperscript{53} separate taxes:\textsuperscript{54} (1) a merchandise circulation tax or turnover tax,\textsuperscript{55} (2) a goods or commodity tax that

\textsuperscript{53} Because the business tax was levied on both gross and net receipts, see note 57 infra, some commentators view industry and commerce as having been subject to five, rather than four, separate taxes prior to 1958. See, e.g., G. ECKLUND, supra note 4, at 27.

\textsuperscript{54} The Communist government that came to power in 1949 was not immediately in a position to restructure the economy along socialistic principles. Its goals were gradually to replace private enterprises with State-owned or cooperative enterprises, to encourage industrialization at the expense of personal consumption, to penalize activities considered to be nonessential, and to increase agricultural productivity. The tax system, used as a tool in achieving these goals, was designed to favor heavy industry, to encourage State enterprises, and to redistribute land and income. Consumer goods, particularly luxuries and semiluxuries, were generally taxed at much higher rates than industrial goods. Discriminatory taxes were levied on private industry and commerce, and price controls made it difficult for private businessmen to shift these taxes to consumers. By 1958, State-owned and cooperative enterprises accounted for more than 95% of the economic activity in the country. The rapid socialization of the country allowed the tax system to be modified in 1958, and most of its anticapitalist features were eliminated. See G. ECKLUND, supra note 4, at 1-2, 72-73. See also A. ECKSTEIN, supra note 7, at 32-58; note 59 infra.

\textsuperscript{55} The merchandise circulation tax, or turnover tax, was introduced in 1953 and appears to have been modeled after a similar tax in Russia. Twenty-two categories of goods were subject to the tax, and those goods were exempt from all other taxes. See A. CHEKHUTOV, supra note 4, at 127. Ecklund reports that the rates of tax ranged from 7% to 66%, and that they were applied to the State price of the taxable good. G. ECKLUND, supra note 4, at 25. Chekhutov states that the tax was computed either as a percentage of the price of the good or as a fixed amount per unit of the good. A. CHEKHUTOV, supra note 4, at 128. He does not indicate the rates of tax or the tax per unit of good. The purchaser paid the tax in the case of imports, agricultural products, and purchases made by wholesale commercial organizations. Producers paid the tax on sales to nonwholesalers. A producer also paid the tax if the goods were used by it in further production. See id. at 127-28, 137.

The turnover tax replaced a number of overlapping taxes, including the stamp tax, the business tax, and a special tax on cotton yarn. See CHAO KUO-CHUN, supra note 4, at 185. The net effect of this substitution was to reduce the tax burden on persons dealing in the taxable goods. The government, however, did not wish to encourage privately owned businesses by extending this tax reduction to them. Consequently, the 22 categories of goods subject to the turnover tax, and thus exempt from other taxes, were primarily goods under the control of State enterprises. See A. CHEKHUTOV, supra note 4, at 127. These goods included pig iron, cement, nonferrous metals, rolled steel, coke, tobacco products, alcohol, flour, matches, and cotton thread. In 1954, the government subjected a number of new commodities to the tax. These new items were primarily goods produced in the private sector, and according to Chekhutov, their taxation was an attempt to reduce the profits accruing to capitalists. See id. at 137. Chekhutov's explanation of the 1954 change needs further elaboration, since on its face it appears to contradict his explanation for the selection of the original 22 taxable categories.

Comparing the turnover tax with the taxes it replaced, Chekhutov asserts that the turnover tax had a number of advantages. First, tax revenue was collected faster and more regularly. Second, the administrative burden of complying with tax obligations was reduced for the State enterprises. Third, the government found it easier to control prices and to achieve greater uniformity of prices among regions of the country. Fourth, a more geographically uniform incidence of taxation of consumers was achieved. Fifth, State enterprises improved their accounting and bookkeeping methods, and the government therefore was able to increase its control over these enterprises. See id. at 128.
applied to items not subject to the turnover tax,\textsuperscript{56} (3) a business tax that applied to commercial and industrial enterprises producing goods that were not subject to either the turnover or goods taxes,\textsuperscript{57} and (4) a stamp tax.\textsuperscript{58}

The consolidated tax, which replaced these taxes,\textsuperscript{59} can be de-

\begin{footnotesize}

\textsuperscript{56} The goods tax, or commodity tax, was introduced in 1950. Producers or wholesale buyers paid the tax, and the rates ranged from 3% to 120% of the wholesale price of the good. See G. Ecklund, supra note 4, at 21-23. In 1953, the number of items subject to the tax decreased from 358 to 173, but this reduction may have resulted partially from a consolidation of the classes of taxable goods. \textit{Id.} at 24. Chekhutov reports that the government increased the tax rates for a majority of the items in 1953. Industrial goods generally were taxed at lower rates than consumption goods. Within the latter class, necessities generally were taxed at lower rates than luxury goods. A. Chekhutov, \textit{supra} note 4, at 129.

\textsuperscript{57} The government introduced the business tax in 1950. Before 1951, the business tax applied to \textit{either} gross receipts or net receipts, but sometime after 1951, the tax applied to \textit{both} gross receipts and net receipts. See G. Ecklund, supra note 4, at 20-21. The tax was levied on industrial enterprises that produced goods not subject to the turnover or the commodity tax. The tax also was levied on commercial enterprises that sold goods not subject to the turnover tax. See A. Chekhutov, \textit{supra} note 4, at 133. State enterprises were exempt from the tax on net receipts, but were taxed on gross receipts. This approach has continued to the present. Exemptions were provided for State monopolies, poor artisans, and certain cooperatives. See G. Ecklund, supra note 4, at 20-21.

The rates of tax on gross receipts varied from 1.5% to 3% for gross receipts from the sale of goods and from 1.5% to 15% for gross receipts from the sale of services. Within these ranges, the lower rates applied to those goods and services which were considered important for economic development. \textit{See id.}

Before 1953, an enterprise that sold more than one product paid tax on gross receipts at the rate applicable to the product subject to the lowest rate. Starting in 1953, however, such an enterprise computed its gross receipts tax at the rate applicable to each item sold. \textit{See A. Chekhutov, supra} note 4, at 131.

Changes also were made in 1953 in the taxation of enterprises that produced taxable goods and used them in further production. The gross receipts tax applied to the movement of semifinished goods between branches and departments of the same enterprise. In 1954, State enterprises were exempted from this rule. The government also increased the number of goods subject to the gross receipts tax. Both changes were an attempt to encourage State-controlled enterprises. \textit{See id.} at 137.

The rates applied to net receipts ranged from 5% to 30%. No minimum level of net receipts was exempt from taxation. Until 1957, a reduction in tax was available for those activities which the government wished to encourage. See G. Ecklund, supra note 4, at 20-21.

\textsuperscript{58} The government revised the stamp tax in 1950, reducing the list of documents subject to the tax from 36 to 25. \textit{See A. Chekhutov, supra} note 4, at 59. All documents used in commercial transactions and in transfers of property were subject to the stamp tax. \textit{See G. Ecklund, supra} note 4, at 23. Documents involved in the transfer of land in pursuance of agrarian reform, passenger tickets and baggage receipts, marriage certificates, and labor agreements were exempt. The tax was levied either as a percentage (.01%, .03%, or .30%) of the amount indicated on the document or as a fixed amount (.02, .05, or .10 yuan). \textit{See A. Chekhutov, supra} note 4, at 59. Revenue from the stamp tax went to local governments. \textit{See Chao Kuo-chun, supra} note 4, at 185. Reports from China in later years suggest that the stamp tax may not have been eliminated entirely in 1958. \textit{See A. Donnithorne, supra} note 4, at 381.

\textsuperscript{59} The government had recognized the need to simplify the taxation of business for sev-
scribed generally as a broad-based turnover tax or as a combination of cascading sales and excise taxes. The tax can be imposed at each stage of production when goods or services are transferred from entity to entity. The tax also is levied at the retail level when the goods or services are sold to the ultimate consumer. No credit is provided for any tax previously paid on the purchase of goods or services. The authors were told that because the tax is paid whether an enterprise is profitable or not, it provides an incentive for a firm to generate enough revenue that some profit remains after payment of the tax.

The CICTA consists of nineteen articles and a schedule of more than forty different rates applicable to more than 100 categories of items. Thirty-five regulations have been issued under the Act.

The 1958 consolidation was preceded by considerable experimentation. A unified industrial and commercial tax had been adopted earlier for petty traders. In the spring and summer of 1958, the government implemented the consolidated tax only for limited groups of commodities in certain areas of the country, though in other areas the tax applied to all taxable goods. In September 1958, when the consolidated tax was promulgated for general application throughout China, the regulations were described as "draft regulations," apparently because the system still was considered experimental. See A. Donnithorne, supra note 4, at 374. These "draft" regulations have never been replaced or superseded by permanent ones.


61. Referring to the tax increase on State enterprises producing rolled metal products, pig iron, steel, and machines which resulted in 1958 when the consolidated industrial and commercial tax became law, Ecklund reports that the government wanted to reduce the profits of such enterprises in order to provide an incentive to better management and efficiency. See G. Ecklund, supra note 4, at 28.

62. The government designed the consolidated industrial and commercial tax rates to generate the same revenues as the four taxes that it replaced. See G. Ecklund, supra note 4, at 27. The rates of the new consolidated tax did not diverge much from the rates previously imposed on the same taxable goods and services. Some rates were lower under the consolidated tax to help enterprises that were operating at a loss or to encourage the production of certain goods, such as fertilizers. Other rates were higher because the profits of certain enterprises were considered to be too high. See A. Donnithorne, supra note 4, at 373.

63. See Detailed Regulations Prescribed Under the Consolidated Industrial and Commer-
The following sections of this article describe the taxpayers and taxable activities, taxable items and rates, payment and collection procedures, violations and penalties, and implications for foreign business of the CICTA.

A. Taxpayers and Taxable Activities

The consolidated industrial and commercial tax reaches all units and individuals engaged in the production of industrial products, the purchase of agricultural products, the importation of foreign goods, commercial retailing, communications and transport, and the rendering of services. Exemptions exist for revenues received (1) by State banks in the form of interest, remittance, handling, and other miscellaneous charges generated in a banking business; (2) by insurance enterprises in the form of insurance premiums, handling charges, proceeds from the sale of remnant materials, and other monies generated in an insurance business (including business reinsured abroad); (3) by agricultural machinery centers from cultivating land for agricultural production units, from the rental of agricultural machinery to agricultural production, and from the performance of other labor; (4) by hospitals, commune hospitals, health care clinics, and veterinary hospitals for providing medical care; and (5) by scientific research units for providing services and selling experimental products and samples.

In addition to these exempt categories, the CICTA provides that, if tax incentives are needed, an exemption or a tax reduction may be available for: (1) revenue received by public canteens or other public enterprises managed by agricultural production cooperatives or by urban street organizations; (2) commissions received on the purchase and sale of industrial and agricultural products by the supply and sales divisions of agricultural production cooperatives if such sales took place at the request and on behalf of State enterprises; and (3) revenue derived from the sale of products made by

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64. At present, only State enterprises, cooperatives, and collectives—not individuals—can engage in substantial business activity. See note 24 supra.

65. See CICTA, supra note 52, art. 2. The authors did not determine whether wholesalers are subject to the tax. The regulations make it clear that the tax is paid only with respect to business conducted within China. See CICTA Regulations, supra note 63, art. 2.

66. CICTA, supra note 52, art. 10; CICTA Regulations, supra note 63, art. 25.
industrial and agricultural enterprises that are operated by schools under work-study programs, including any proceeds received for performing processing work and any proceeds derived from performing other labor.\(^{67}\) The extent to which these tax exemptions or tax reductions have been granted in practice is unclear, but there is some indication that tax reductions have been granted to infant or ailing domestic enterprises.\(^{68}\)

**B. Taxable Items and Rates**

The CICTA delineates the items subject to the tax, the applicable tax rate, and the method of computing the tax base.\(^{69}\) Although the sales price is the stated tax base,\(^{70}\) the elements of price vary for imported goods. In the case of imported industrial goods, the tax is computed on the basis of the sum of the cost-insurance-freight (C.I.F.) price of the good, the customs duties, and the tax itself.\(^{71}\) In the case of imported agricultural products, the tax is computed only on the basis of the C.I.F. price.\(^{72}\) The State takes into account the rate of the consolidated tax in setting the price of various controlled domestic goods and services.\(^{73}\) In the past, the prices and the rates have not been changed very often.

Over 100 categories of taxable industrial and agricultural products are listed,\(^{74}\) some of which are divided further into subcategories.\(^{75}\) The rates applicable to the enumerated items range from

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\(^{67}\) CICTA, *supra* note 52, arts. 11, 12.

\(^{68}\) In 1962, a reduction or exemption was granted for indigenous chemical fertilizers, insecticides, and farm tools made by communes and production teams. In 1963, a tax reduction for unspecified new industrial consumer goods was reported. See A. Donnithorne, *supra* note 4, at 373. See also Wei Min, *supra* note 4, at 23. The provinces and cities have some authority to grant an exemption or a reduction in tax. CICTA, *supra* note 52, art. 12. The authors are unsure of the extent of this authority.

\(^{69}\) CICTA, *supra* note 52, Schedule of Taxable Items and Tax Rates.

\(^{70}\) Id. arts. 4-5, 7-8; CICTA Regulations, *supra* note 63, art. 10.

\(^{71}\) CICTA, *supra* note 52, art. 6; CICTA Regulations, *supra* note 63, art. 11.

\(^{72}\) CICTA Regulations, *supra* note 63, art. 11.

\(^{73}\) Donnithorne remarks that little information is available about changes in the rates of tax since 1958. A. Donnithorne, *supra* note 4, at 373. This lack of information is probably due to the small number of changes.

\(^{74}\) E.g., cigarettes, wines, sugar, tea, cotton yarn, machine-made linen, silk, leather, thermos bottles, bicycles, bamboo, gas, coke, ores, and machinery. CICTA, *supra* note 52, Schedule of Taxable Items and Tax Rates.

\(^{75}\) For example, sugar is divided into machine-made sugar, native sugar, saccharin, and maltose; cotton yarn is divided into raw cotton yarn, worsted yarn, and artificial yarn; cigarettes are divided into five grades; alcohol is divided into grain alcohol, wood alcohol, and alcohol made from substitute materials; thermos bottles are divided into metal bottles, bamboo bottles, and glass liners. Id.
1.5% (for raw cotton cloth) to 69% (for Grade A cigarettes). More than forty different rates exist within this range.\textsuperscript{75.1}

Although a five percent catch-all rate applies to any industrial product that is not listed specifically in the categories of taxable items, no similar catch-all rate applies to unlisted agricultural products. Agricultural products that are not listed specifically are not subject to the tax at the time of purchase or at the time of importation. Such products are taxable only when they are sold at retail.\textsuperscript{76}

The CICTA also sets forth a detailed list of taxable items under the categories of communications and transportation, services, and commercial retailing,\textsuperscript{77} which are subject to four tax rates ranging from 2.5% to 7%.\textsuperscript{78} The communications and transportation category is subject to a 2.5% tax rate and includes the following items: mail and telecommunications, railways, air transportation, shipment, loading and unloading, communications and transportation, and trains and public buses.\textsuperscript{79} The items listed in the services category are more extensive than those listed under communications and transportation and are subject to three tax rates. Contracting, installation, designing, construction, processing, storage, and warehousing services are taxed at a rate of three percent.\textsuperscript{80} Restaurant, hotel, rental, and advertising services are taxed at a five percent rate.\textsuperscript{81} Factoring, bailment, and custom-made brokerage services are taxed at seven percent.\textsuperscript{82} A three percent tax rate applies to commercial retailing, but no specific items are listed under this category.\textsuperscript{83} No catch-all rate is provided for items not specifically listed. In addition to the above taxes, local governments may levy a one percent surtax on the consolidated tax.\textsuperscript{84}

The CICTA provides a tax advantage for a firm that is vertically

\textsuperscript{75.1} E.g., 2% for gas, 4.5% for motor vehicles and ships, 5% for machinery and electric power, 7% for nonmetallic minerals, 20% for cement, 35% for wrist watches and imported woolen goods, 40% for cow leather and tea, and 60% for white or yellow wine.

\textsuperscript{76} CICTA Regulations, \textit{supra} note 63, art. 3(2).

\textsuperscript{77} CICTA, \textit{supra} note 52, Schedule of Taxable Items and Tax Rates.

\textsuperscript{78} These rates appear to have remained unchanged since 1958. \textit{See} A. DONNITHORNE, \textit{supra} note 4, at 373.

\textsuperscript{79} CICTA, \textit{supra} note 52, Schedule of Taxable Items and Tax Rates.

\textsuperscript{80} \textit{Id.}

\textsuperscript{81} \textit{Id.}

\textsuperscript{82} \textit{Id.}

\textsuperscript{83} From the authors' limited experiences as consumers in China, it appears that retail prices are stated inclusive of the three percent tax.

\textsuperscript{84} Neither the CICTA nor the CICTA Regulations mentions this surtax.
integrated. An integrated firm that produces its own goods and provides its own services will pay less tax than a firm that purchases identical goods and services from the third parties, because such purchases are likely to be subject to the tax. By producing rather than purchasing such goods and services, the integrated firm avoids the tax. In order to reduce the tax advantage of integrated firms, the CICTA taxes certain items produced by an enterprise and used by the same enterprise in further production.\textsuperscript{85} Although the CICTA lists only wine, cotton yarn, and leather,\textsuperscript{88} this rule apparently applies also to furs, woolen yarn, cane or beet sugar, and liquid corn sugar. The same rule governs products manufactured by an industrial enterprise and used by it for capital construction rather than further production.\textsuperscript{87} The tax on products subject to this rule is computed on the basis of the price of identical products sold by the enterprise to outside parties.\textsuperscript{88} If no identical products are sold by the enterprise, the tax is computed on the basis of a price determined in consultation with the tax administration.\textsuperscript{89}

C. \textit{Payment and Collection Procedures}

The consolidated tax is paid on the basis of a taxable period that is determined by the tax administration for each taxpayer.\textsuperscript{90} The regulations specify that the taxable period may be one day, three days, ten days, fifteen days, or one month.\textsuperscript{91} Payment is due within five days following the end of monthly taxable periods and within three days following the end of all other taxable periods.\textsuperscript{92} The rapid collection of the tax provides the State with a current source of revenue, especially from State enterprises that otherwise would turn over any profits only quarterly.

The regulations also contain a set of rules, based on the type of

\textsuperscript{85} CICTA, \textit{supra} note 52, art. 4; CICTA Regulations, \textit{supra} note 63, art. 6.
\textsuperscript{86} CICTA, \textit{supra} note 52, Schedule of Taxable Items and Tax Rates.
\textsuperscript{87} CICTA Regulations, \textit{supra} note 63, art. 6.
\textsuperscript{88} \textit{Id}.
\textsuperscript{89} \textit{Id}. The authors were unable to ascertain the approach used by the tax administration in establishing this price.
\textsuperscript{90} CICTA, \textit{supra} note 52, art. 14; CICTA Regulations, \textit{supra} note 63, art. 19.
\textsuperscript{91} CICTA Regulations, \textit{supra} note 63, art. 19. For example, in the city of Dalian, which is heavily industrialized, the period is one day for major enterprises and ten days for smaller enterprises.
\textsuperscript{92} \textit{Id}. art. 20. Special measures may be adopted to collect the tax from certain types of smaller enterprises. CICTA, \textit{supra} note 52, art. 17. The authors have no information about these measures.
enterprise, for determining when tax liability arises. For an industrial enterprise that uses bank settlement procedures, liability arises on the day that sales proceeds are transferred to the account of the enterprise.\textsuperscript{53} If bank settlement procedures are not used, the tax administration determines the appropriate time in accordance with the accounting system and operating conditions of the enterprise.\textsuperscript{54} For taxpayers engaged in the purchase of agricultural products, the regulations state only that liability for the tax arises on the day payment for the products is made.\textsuperscript{55} For enterprises that import goods, liability arises on the day that the goods are brought into China or on the day that an application for importation is made.\textsuperscript{56} Neither the CICTA nor the regulations specify who determines which of the two dates is applicable. For a taxpayer engaged in commercial retailing, liability for the tax arises on the day that proceeds from the sale are received.\textsuperscript{57} No examples or definitions explain "the day that proceeds are received." Because most, if not all, commercial retailing takes place on a cash basis, however, the determination of the day of receipt presumably creates few problems. For a taxpayer engaged in communications and transportation or in the rendering of services, the regulations state only that the liability for the tax arises on the day that the revenue is received.\textsuperscript{58} The tax is paid to the local branch of the People’s Bank of China or directly to the tax administration in areas with no local bank branches.\textsuperscript{59} An enterprise that is unable to compute the amount of tax due may pay an amount based on the tax paid for the previous taxable period, or it may pay an estimated amount until the exact amount owed is determined.\textsuperscript{60}

D. Violations and Penalties

The tax administration deals with all violations of the CICTA except the most serious, which must be handled by the courts.\textsuperscript{61} The tax administration may impose a late payment penalty of .1%
per day on the amount of tax in arrears. In the case of tax evasion, it may impose a penalty of up to five times the amount of tax evaded. The tax administration may commend or materially reward persons who report acts of tax evasion. A taxpayer who disagrees with the decision of the tax administration, after paying the amount of tax due, may appeal either to the local people's committee or to the next higher level within the tax administration. Such appeals, however, are rare.

E. Implications for Foreign Business

The extent to which the consolidated tax will be applied to particular types of foreign investment remains uncertain due to the lack of foreign economic activity in China and the tax administration's nonassertive attitude toward the collection of taxes. The tax probably will not be levied on foreign firms that export to China, however, because the Chinese importer pays the tax. In other situations, questions arise about the application of the tax to compensation trade agreements and to joint ventures. For example, will the tax apply to the importation of technology by a joint venture? Will the government levy a tax on the interest received by foreign creditors on loans made to such ventures? Will foreign equipment contributed in a compensation trade agreement be taxable? Will goods brought into China for processing be treated as having been imported?

The Chinese have not yet reached a position on these and similar questions. Apparently, foreign investors are attempting to clarify in their contracts and agreements with the Chinese the extent to which the consolidated tax will apply. In the negotiation of some
joint venture agreements, the Chinese have been willing to consider granting an exemption from the consolidated tax, even though the Joint Venture Law provides an exemption only from the income tax.\textsuperscript{111}

III. SPECULATION ABOUT THE FUTURE

The impression of the authors is that the Chinese perceive that the taxation of joint ventures is their most immediate need. The participation of foreigners in the ownership of Chinese corporations, which is authorized by the Joint Venture Law,\textsuperscript{112} will require the Chinese to adopt a somewhat "modern" corporate income tax. A rate compatible with rates imposed by other countries, for example, thirty-five to forty-five percent, including any surtax, might be expected.\textsuperscript{113} This corporate income tax presumably would apply to branch offices. It also might include a withholding tax on dividends distributed to foreigners. A withholding rate between fifteen and thirty percent would be consistent with rates used throughout the world.\textsuperscript{114} Under a modern corporate income tax, the Chinese would assert jurisdiction over foreign income on a global basis and probably would deal with problems of double taxation by using a foreign tax credit.

This approach to taxing joint ventures would be roughly comparable to that used by socialist countries in Eastern Europe.\textsuperscript{115} If the

satisfies certain requirements. The need to meet these requirements restrains the degree to which U.S. investors can write their own income tax agreements.

111. See notes 44-49 supra & accompanying text.
112. Joint Venture Law, supra note 6, art. 1.
113. Ren Jian-xin, Director of the Legal Affairs Department, China Council for the Promotion of International Trade, made the following comments with respect to the rate of income tax:

As known to all, the rates of income tax imposed by developed countries are generally higher than those by developing countries, say about 50% usually by the former and 30% by the latter in most cases. The rate of income tax to be levied by China is now under study. Since we welcome foreign investment in China, I believe the rate of Chinese income tax will be determined with due reference to the practices of other countries, particularly those of developing countries.

Prepared Statement of Ren Jian-xin, distributed at the Practising Law Institute's program, "A New Look at Legal Aspects of Doing Business With China" (New York City, Dec. 12-14, 1979). Rong Yiren has commented that he hopes the rate of corporate taxation will not exceed that of the United States. Wall St. J., Jan. 14, 1980, at 15, col. 2. A 17% rate, identical to the Hong Kong tax rate on companies, has been suggested for industrial zones near Hong Kong.

114. The issue of a withholding tax is currently the subject of intense debate in China.
115. See generally P. Jonas, supra note 7.
Chinese were to adopt such an approach, the United States might consider entering into an OECD-type tax treaty with China similar to its treaties with Poland, Hungary, and Romania. One inducement to negotiate such a tax treaty with China would be to obtain a reduction in the Chinese withholding tax on dividends distributed to U.S. corporations. The Chinese already have demonstrated their willingness to lower their tax on foreign shipping under a bilateral agreement and might adopt a similar attitude towards a withholding tax on dividends. Nothing indicates that the Chinese would be unwilling to enter into such a tax treaty with the United States, though China might prefer the U.N. model treaty rather than the OECD model that the United States prefers.  

The enactment of the Joint Venture Law also anticipates the need for a modern income tax on individuals. Once the more pressing need for a modern corporate tax has been satisfied, it is reasonable to expect attention to focus next on designing an income tax applicable to foreign individuals resident in China. The adoption of an income tax on foreigners may occasion a re-examination of the taxation of resident nationals, especially those who might receive relatively high incomes as a consequence of the influx of foreign investment.  

Speculating about the future role of the consolidated industrial and commercial tax is more difficult. The Chinese are aware that the cascading or pyramiding feature of the tax can produce a substantial burden on certain types of foreign investment. They also are aware that most countries will not grant a foreign tax credit for the consolidated tax. Nonetheless, the Joint Venture Law provides an exemption only from the income tax and not from the consolidated tax. The authors were told, however, that the cascading or pyramiding feature of the consolidated tax is being re-evaluated. Although the Chinese have studied the value added tax, which provides a credit for prior taxes paid and thus eliminates cascading, no change appears imminent.


117. See Joint Venture Law, supra note 6, art. 11 (referring to a Chinese personal income tax on the wages, salaries, or other legitimate income earned by a foreign worker or staff member of a joint venture).