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12-1-1989

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Recommended Citation
Jinyan Li, *Taxation of Foreign Investment in the People's Republic of China*, 12 Loy. L.A. Int'l & Comp. L. Rev. 35 (1989).
Available at: http://digitalcommons.lmu.edu/ilr/vol12/iss1/8

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Taxation of Foreign Investment in the People's Republic of China

JINYAN LI*

I. INTRODUCTION

Taxation in China is almost as old as the country itself. Land tax records go back as far as the sixteenth century B.C., and a substantial body of tax legislation has been enacted since the founding of the People's Republic in 1949. The present Chinese tax system, however, is mostly a product of the 1980s. The economic reforms of the post-Mao era necessitated a fundamental restructuring of the fiscal system. Tax laws have been introduced to levy taxes on domestic enterprises. As a consequence of the "open to the world" policies announced in 1979, China enacted legislation to tax foreign investment and business activities in China.

China's tax system, as it applies to foreigners, has evolved in a piecemeal fashion and the system itself remains far from complete. Nonetheless, substantial progress has been made towards establishing the groundwork for a comprehensive tax regime that serves China's interests and reflects international practices.

China's present policies regarding the taxation of foreigners are motivated by three primary goals: first, increasing revenue; second, using the tax mechanism as a regulatory tool for implementing the nation's economic policies; and third, bringing China's tax system into conformity with general international tax practices.

II. TAXATION OF FOREIGN INVESTMENT - AN OVERVIEW

To date, China has no single tax code. Instead, different types of enterprises are subject to separate laws and regulations. Presently, six laws apply to business profits and two apply to personal income. Foreign individuals in China are taxed under the Individual Income Tax Law of 1980 ("ITT"). Depending on the form of the investment, foreign investment and business are taxed under either the Joint Venture Income Tax Law of 1980 ("JVIT") or the Foreign Enterprise Income Tax Law of 1982 ("FEIT"). Usually, implementing regulations and notices are issued in an unsystematic manner. Many notices are un-

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published as "internal" (or "*neibu*") communications between the various tax offices that supplement or interpret previously issued regulations. In addition, China has concluded about twenty tax treaties which limit double taxation, reduce certain tax rates and help to define concepts not explained in China's legislation.

A. Individual Income Tax

The basic rule under the individual income tax law, as in most countries, is that residents are taxed on their world income, while non-residents are taxed only on income from sources within China. In practice, however, most foreigners living in China are taxed only on income derived from Chinese sources.

The tax is levied on six specified categories of income including: royalties; interest, dividends and bonuses; income from the lease of property; and employment income. Each category of income is computed and taxed separately. In particular, only employment income is taxed at progressive rates; the excess over 800 yuan per month is taxed at rates which, until they were halved in 1987, rose from 5% to 45%. All other forms of income are taxed at a flat rate of 20% which is also the rate applied to income paid to non-residents.

B. Joint Venture Income Tax

The JVIT applies only to equity joint ventures established pursuant to the Joint Venture Law of 1979. The tax is charged on the income of Chinese-foreign joint ventures from production, businesses and other sources, including the income from branches inside and outside China. Tax is levied at a flat rate of 30%, to which is added a local income tax, bringing the effective rate to 33%. In addition to the tax on profits, a further tax of 10% is levied on profits remitted outside China. But where a participant in a joint venture reinvests a share of the profits in China, for a period of not less than five years, it is eligible for a refund of 40% of the income tax paid by the venture with respect to the reinvested amount. Various other tax reductions or exemptions are offered to promote certain types of investment.

C. Foreign Enterprises Income Tax

Where a foreign enterprise carries on business in China through a branch operation or representative office, it is required to pay FEIT on the income earned by that branch or office. For the purposes of the legislation, "foreign enterprise" means a foreign company, enter-

prise or other economic organization having an establishment in China engaged in independent business operations or co-operative production or joint business operations with Chinese enterprises. A foreign enterprise not established in China is subject to a flat rate of 20% on income from dividends, interest, rents, royalties and sources in China. This tax must be withheld by the paying business.

For income earned by a foreign enterprise established in China, the tax is charged at progressive rates, rising from 20% on the first 250,000 yuan of taxable income for the year to 40% on income in excess of 1 million yuan. In addition, a 10% local income tax is assessed, bringing the total rate to a maximum of 50%. Consequently, except in the case of the smaller operations, an equity joint venture will owe less tax than a foreign participant in a contractual joint venture even though there is an additional 10% tax on profits remitted outside the country by the equity joint venture. As in the case of equity joint ventures, various tax incentives are provided to promote investment.

D. Consolidation Industrial and Commercial Tax

The Consolidation Industrial and Commercial Tax ("CICT") is best described as a turnover tax. Altogether, the CICT applies to over 100 categories of goods or transactions and prescribes forty-two different rates, ranging from 69% on top quality cigarettes to 1.5% on certain basic necessities. Retail sales are taxed generally at 3% and the rendering of services at rates between 3% and 7%. It is the tax on services which is of primary interest and concern to foreign businesses. For example, when a Hong Kong company entered into a contractual joint venture with a Shanghai research institute to repair and resell computer equipment, the company was liable for the CICT (at 3%) on the repair fees charged as well as the tax under the FEIT on net profits.

E. Real Estate Tax

The Real Estate Tax is imposed in cities, counties and townships. It is assessed against lessees, mainly proprietors of businesses, and owners of houses and buildings. Its calculation is based on the value of the property (at the rate of 1.2%) or on rent received (at a rate of 12%).

F. Vehicle and Vessel License Tax

The Vehicle and Vessel License Tax applies to most types of motor vehicles and motor boats and to some types of non-motorized transport. This tax may be levied by the provinces, autonomous regions and municipalities under central control and is normally paid yearly as a form of license fee.

G. Land Use Tax

Until recently, local governments imposed a "land use fee" on the occupiers of land. National regulations, which went into effect on November 1, 1988, re-characterize this "fee" as a "tax." The new regulations establish minimum and maximum rates per square meter per year, though local governments generally retain the power to fix rates for particular property within the statutory range.

H. Customs Duties

Customs duties are levied on imports and certain exports under a comprehensive customs scheme. In 1983, China joined the International Customs Cooperation Council, based in Brussels. In 1985, new customs regulations and duty rates were issued, and in 1987, a new customs law was enacted. These developments have brought China's customs regime more closely in line with international practices.

I. Stamp Tax

A new Stamp Tax Law was passed in June, 1988, and came into effect on October 1, 1988. Under the Stamp Tax Law, all individuals and entities who write or obtain specified documents are liable for the tax. The "specified documents" include contracts for purchase and sale, the undertaking of processing work, the contracting of construction projects, the leasing of property, the transportation of goods, storage and custody of goods, the lending of funds, the insurance of property and technology, conveyances, business accounts books, registration certificates for rights and licenses, and other documents determined taxable by the Ministry of Finance. Tax rates vary in accordance with the nature of the documents. For example, purchase and sale contracts are taxed at 0.003% of the sale price and construction and installation contracts are taxed at 0.003% of the fee charged. Contracts to process work and transport goods are taxed at 0.005%.

Taxpayers are required to pay the applicable tax rate by purchasing and affixing tax stamps on the taxable document. Duplicates or

manuscript copies of documents for which the Stamp Tax has already been paid are exempt. Also exempt are social welfare entities, schools and instruments written by property owners donating property to the government.

III. Recent Developments

A. Individual Income Tax

Beginning August 1, 1987, individual income tax on employment income for foreigners was effectively cut in half. This reduction was not a change in the tax rates per se, but rather a discount on the total amount of tax owed under the existing rates. Accordingly, Chinese citizens are still required to pay income tax at full rates.

There are three primary motivations behind this reduction in individual income tax. First, it serves as an incentive to foreign investors and individuals to work in China. Second, it brings China in line with the international trend towards lowering individual income tax rates. Third, in conjunction with the new 90-day rule described below, a reduction in income tax burdens will encourage greater taxpayer compliance with the law. This is particularly relevant in view of reports of high tax avoidance in China.

China employs a 90-day rule to determine whether, and to what extent, individual income tax is to be assessed on foreign passport holders. (A 183-day rule is applied for citizens of countries with which China has signed a tax treaty.) If an individual's residence in China does not exceed ninety days, compensation from employers outside of China is exempted from taxation. The rule is not applied, however, to foreign employees of Chinese enterprises or Sino-foreign joint ventures, nor to employees of foreign companies which are deemed to have a "permanent establishment" in China.

Prior to 1988, the tax laws in this situation were extremely complicated. In practice, the Chinese authorities based their treatment of foreigners working in China primarily upon the type and duration of the visa issued. New rules have now been formulated and the following proposition may be advanced:

(i) if the period of presence in China exceeds 90 days in a single fiscal year, no exemption will be granted;

(ii) where the period exceeds 90 days, income earned in the first 90 days as well at that earned thereafter is taxable;

(iii) in calculating the period, it is the total number of days of ac-

tual presence in China which is calculated, whether the period is consecutive or cumulative.

It should be remembered that the 90-day rule is concerned only with the ability to tax remuneration paid by non-resident employers for work performed in China. Consequently, the above rules are often modified where a tax treaty applies. In such a case, if the employer is a non-resident enterprise and the taxpayer is not present in China for a period or periods exceeding, in the aggregate, 183 days in the particular calendar year, employment income earned by a foreign resident is not taxable in China. The relevant period in that case, therefore, is 183 days rather than 90 days.

B. Joint Venture Income Tax and Foreign Enterprise Income Tax

1. Transfer Pricing

In 1987, the Shenzhen Special Economic Zone introduced the *Provisional Measures for the Administration of Taxation in Respect of Transactions and Business Operations between Enterprises with Foreign Investment in the Shenzhen SEZ and Their Affiliates* ("*Transfer Pricing Measures*"), which went into effect on January 1, 1988. This legislation is China's first attempt to regulate tax abuses occasioned by artificial pricing between related entities.

The *Transfer Pricing Measures* apply to transactions between enterprises with foreign investments located in the Shenzhen Special Economic Zone. These investments include equity and cooperative joint ventures as well as wholly foreign-owned enterprises and their "affiliates." The term "affiliate" is defined broadly as "two or more companies with direct or indirect relations in terms of administration, control, capital, etc." The *Transfer Pricing Measures* provide that any transaction between an enterprise with foreign investments and its affiliate must be based on an arm's length price. The Shenzhen Tax Bureau is then granted authority to levy tax on profit assessed in accordance with standards set forth in the *Transfer Pricing Measures* in case the arm's length criterion is not met. For example, in the case of a sale of goods, the tax authorities have the right to determine profit by one of the following three methods:

(i) by reference to the arm's length price of the same kind of product on the open market (i.e., the controlled instead of the state-regulated price);
(ii) by reference to the cost of the product, in which case the profit margin shall generally be no less than 5%; or

(iii) to assess profit by "any other reasonable method."

Similarly, in the case of royalties for the transfer of proprietary technology, the *Transfer Pricing Measures* require that the royalty charged be equal to that charged to a non-affiliated company. Otherwise, the tax authorities have the discretion to set a royalty "in accordance with general standards" for tax purposes.

As mentioned above, the promulgation of the *Transfer Pricing Measures* by the Shenzhen Tax Bureau has not been well publicized. Moreover, it is still too early to determine whether the Shenzhen Tax Bureau will aggressively enforce the *Transfer Pricing Measures*. If the *Transfer Pricing Measures* are intended to be followed by similar national legislation, difficult policy issues will arise. One must query whether a crackdown on the transfer price between foreign parents and their Chinese investments is consistent with the Chinese policy of encouraging foreign parties to make machinery, equipment and technology available on preferential terms. In fact, in certain circumstances, Chinese authorities have been known to demand that a foreign party reduce its royalty for technology licensed to a proposed joint venture company as a precondition to approval of the joint venture project. In such a case, a foreign party could be faced with the prospect of agreeing to a technology licensing royalty far below market value in order to have the project approved, while paying tax based on the market value.

2. Tax Incentives

Subsequent to the promulgation of the JVIT and the FEIT, various regulations and notices were issued to grant fiscal incentives to foreign investment. The majority of these incentives fall within one of two categories: those designed to attract investment to particular locations—such as the Special Economic Zones ("SEZs"), the "Old Districts" within fourteen coastal cities, Economic and Technological Development Zones ("ETDZs"), and "open" coastal cities—and those designed to attract investment by certain types of enterprises, in particular, those which are export-oriented or technologically-advanced.

a. Incentives in Special Areas

By virtue of the Special Economic Zone and Fourteen Coastal Cities Tax Incentives Regulations (1984), all enterprises with foreign investment in the SEZs, irrespective of business form, are normally

taxed at a reduced rate of 15% on business income instead of the normal 30% rate under the JVIT or the progressive rates of 20% to 40% under the FEIT. The local government generally waives local income taxes.

Enterprises engaged in transportation, agriculture, forestry and other low-profit business activities are exempt from income tax for the first two profit-making years. Thereafter, the enterprises are taxed at half the applicable rate for the third to fifth years if the scheduled operation period is more than ten years. Enterprises engaged in service trades with foreign investments exceeding $5 million and a scheduled period of operation of ten years or more are exempt from income tax for the first profitable year, and the tax rate is reduced by half for the second and third profit-making years. Furthermore, a foreign investor in a joint venture is exempted from the 10% withholding tax on profits remitted outside the country. The withholding tax on investment income is reduced from 20% to 10%. The withholding tax may be exempted altogether for royalty payments for advanced technology.

With the Ministry of Finance's approval, productive enterprises in these areas may enjoy a national income tax rate of 15%. To qualify for this rate, a project must either be "technology-intensive" (related to energy, transportation or communications development), or represent foreign investment greater than $30 million and have a long pay-back period. Enterprises engaged in a wide range of specified industries that do not satisfy these criteria may otherwise apply to local authorities for a 20% reduction in national income tax.

The income tax rate for all foreign-invested enterprises engaged in production that are located within ETDZs is 15% and provides automatic exemptions from payment of the 10% withholding tax on remitted profits. In addition, with the approval of local tax authorities, productive enterprises approved to operate over ten years may be exempt from income tax for the first two profit-making years and enjoy a 50% reduction for the following three years. Exemptions are also available from CICT tax on reports as well as imported materials used in the manufacture of exported goods.

Within the past few years, certain local governments within Guangdong and Fujian Province where the SEZs are located have introduced investment incentives in a piecemeal fashion. In June of 1988, national regulations unified these incentive measures and applied them to areas along the eastern and southern coasts and to the

delta regions of Changjiang (Yangtsze River), Zhujiang (Pearl River) and the Golden Triangle region in Fujian province.

Enterprises with foreign investment located in the three Delta regions and "Coastal Open Economic Zones" ("COEZs") are taxed under the COEZs Tax Regulations (1988) at 15% if they invest in technology-intensive projects, projects in energy, transportation and port construction, or projects in which the foreign investor contributes more than $30,000,000. Enterprises are entitled to a 20% reduction in tax if they are engaged in machine building and electronics; metallurgy, chemical and building materials industry; light industry; textile and packaging industry; medical and pharmaceutical industry; forestry, animal husbandry, agriculture, poultry raising and related processing industry; or the construction industry. The withholding tax for investment income sources in these areas is 10%. The local government normally waives the local tax.

b. Incentives For Preferred Forms Of Investments

As mentioned above, a foreign enterprise which does not have an "establishment" in China pays taxes at a flat rate of 20% on the gross amount of any dividend, interest, rent or royalty received from a source within China. Dividends from equity joint ventures are taxed at a 10% rate which is generally exempted in SEZs and ETDZs. Exemptions apply in the cases of interest on loans made to approved bodies at preferential rates and to a number of bond issues made on international markets. Interest from loans, advances and deferred payments provided under credit or trade contracts signed between 1983 and 1990 by foreign enterprises with Chinese entities is taxed at a reduced rate of 10% during the effective term of the contract. Rental income from leasing fees for equipment under contracts entered into between 1983 and 1990 is taxed at 10%. Fees for the use of proprietary technology may be taxed either at a reduced rate of 10% or exempted entirely where the technology is advanced and transferred on favorable terms to Chinese parties.

"Export-oriented" enterprises are defined as enterprises whose products are mainly for export, which have a foreign exchange surplus after deducting from their total annual foreign exchange revenues the annual foreign exchange expenditures incurred in production and operation and the foreign exchange needed for the remittance abroad of the profits earned by foreign investors.

Export-oriented and technologically-advanced enterprises enjoy

a number of tax advantages in accordance with the 1986 Provisions for the Encouragement of Foreign Investment. A qualifying export-oriented enterprise, which can be either a joint venture or a wholly foreign-owned enterprise, will be entitled to a 50% reduction in tax after the expiration of the tax holidays under the JVIT or FEIT. This privilege continues as long as the enterprise continues to qualify. For enterprises in the SEZs and the ETDZs, which would otherwise pay tax at a rate of 15%, the reduced rate is 10%. A qualifying technologically-advanced enterprise receives only an additional three-year "tax holiday" at half the normal rate. Enterprises in SEZs and the ETDZs will pay income tax at a 10% rate for the same period. When foreign investors in export-oriented enterprises or technologically-advanced enterprises remit profits abroad, the amount remitted is exempted from income tax. The exemption appears to apply as long as the enterprise continues to qualify.

However, within the past two years, local governments have issued a flood of fiscal and non-fiscal incentives aimed at attracting foreign investments. Although most of these are clearly within the local government's scope of authority, the central government has criticized many of them recently for exceeding the scope of national legislation. Thus, foreign investors should be aware of the danger of relying on incentives that may indeed be too good to be true. Where benefits are being offered by legitimate local government authorities, doubts would not normally be raised. If, however, an investor is made aware of possible problems, he or she may seek to obtain some sort of verification.

c. *Tax Treaties*

During the past few years, China has negotiated tax treaties with most of its major trading partners. Already in force are treaties with Belgium, Canada, Czechoslovakia, Denmark, France, the Federal Republic of Germany, Japan, Malaysia, Norway, Singapore, Sweden, Thailand, the United Kingdom and the United States.

These tax treaties do not specifically provide investment incentives, but insofar as they modify the general domestic tax rules, they are very important to investors of a treaty country. The treaties generally modify and, in most cases, reduce the withholding tax rates applied to investment income. They also provide measures to eliminate double taxation, and most significantly, ensure that Chinese tax

incentives actually benefit the investors by including a "tax sparing" clause.

A "tax sparing" clause usually provides that the home country of an investor will allow the investor to claim a foreign tax credit for the income taxes "spared" by the Chinese government. Without such a clause, the investor would not receive a foreign tax credit for taxes exempted or reduced in China under the various incentive schemes. Thus, the taxpayer may have to pay tax to the home country on income earned in China. Although most of China's tax treaties contain tax sparing clauses, the China-United States Treaty does not. These operate either by recognizing the specific exemptions or relief provided in the Chinese legislation or by designating a higher rate of tax to have been withheld regarding dividends, interest and royalties.

It should be noted that the lack of tax treaty interpretations and qualified authorities to interpret the tax treaties makes it difficult for foreign investors to rely upon the literal meaning of the treaties. Take, for example, foreign companies licensing technology to Chinese companies in conjunction with their involvement in a project for the sale and installation of equipment. Tax treaties clearly mandate that such companies pay income tax on a net basis because the royalties are connected with the foreign company's permanent establishment in China. However, despite the language of the tax treaties, Chinese tax authorities often ignore the permanent establishment of these companies in China and instead levy a withholding tax. Chinese tax authorities are, with some justification, fearful that the foreign party will attempt to deduct excessive head office research and development costs along with other costs, and therefore desire to opt for the simplest method of taxation.

To assist in uniformly interpreting and implementing the treaties, the central government tax authorities issued several notices interpreting various treaty provisions. Although such notices resolve many problems, they may also raise others due to vagueness and ambiguity in drafting.

IV. FUTURE DIRECTIONS

In a remarkably short period of time, China has created a tax system which falls within the mainstream of international taxation systems. At the same time, China also has established a substantial network of tax treaties. China seeks to retain a reasonable proportion of the profits generated by foreign investment in the form of taxes.

For the most part, China's tax system is conducive to such investment and should not produce any unpleasant surprises to foreign enterprises. Nonetheless, additional changes in Chinese tax law will take place in the years to come.

A. Draft Law on Foreign-Invested Enterprises

According to reports, some time this year the National People's Congress may pass a new tax law that will supersede the 1980 JVIT and 1982 FEIT. This new law will unify tax treatment for foreign-invested enterprises, including equity joint ventures, cooperative joint venture and wholly foreign-owned enterprises and provide still more incentive to foreign investors. A draft contains provisions reducing the base central income tax rate to 25% and increasing the local income tax rate. The local income tax rate is 10% of the central rate, which is often reduced to a fixed 5% through tax incentives. However, these changes are presented as mere proposals with an alternative also set forth establishing the central income tax rate at 30% and the local rate at 3%.

Another provision reduces the central income tax to 15% for all foreign-invested enterprises in SEZs and enterprises "engaged in production" in ETDZs. Substantially identical treatment for SEZ and ETDZ enterprises is already available under previous regulations.

The draft proposes to reduce the central income tax rate for enterprises engaged in production in open coastal economic zones to 20%. The 1988 regulations affecting COEZs already establish a rate of 15% for "technologically intensive" and other specified productive enterprises. Although the draft encompasses a wider range of beneficiaries, it provides a higher rate than the 1988 regulations. If the draft law supersedes the 1988 regulations with respect to COEZs, many enterprises could conceivably experience a 5% increase in income tax.

One provision discusses the elimination of the 10% withholding tax on repatriated profits of foreign equity joint venture parties. The 1986 Provisions of the Encouragement of Foreign Investment already exempt investors from this tax where the joint venture is either an "export-oriented" or "technologically advanced" enterprise.

Exemptions on income tax are provided for the first two profit-making years and 50% reductions for the following three years in a wide range of specified fields, including "industry," various mining projects, communications, transportation, construction, technological

development, and agriculture. "Low profit" enterprises and those located in "poor areas" are eligible for additional 15% to 30% reductions in the ten years following expiration of the preceding benefits. Similar tax holidays appear in most of the regulations discussed above. Notably, the 1986 Provisions for the Encouragement of Foreign Investment extends the 50% reduction in income tax for all enterprises that export more than 70% of their production.

The draft proposes a refund of all taxes on profits that have subsequently been reinvested for a minimum of five years, either in one's own enterprise or another enterprise with foreign investment in China. It would reduce the withholding tax paid from technology licensing fees from 20% to 10%, and provide exemptions for technology that is "advanced and provided on preferential terms." The 1984 SEZ Regulations already contain virtually identical provisions with respect to SEZ, ETDZ and Old District enterprises. Finally, the draft would deduct foreign taxes paid on income derived from activities outside of China for enterprises that have their head office in China. The maximum deduction would be the amount otherwise payable under China's tax rates.

Comparisons between the draft law and existing regulations indicate that the incentives extended by the draft are fairly modest, particularly in foreign-invested enterprises located in SEZs, ETDZs and COEZs. Yet, the draft would eliminate some confusion generated by the current system. For example, the JVIT provides for a local tax which equals 10% of the national tax levied. The FEIT, by contrast, provides a stable 10% local tax. Eliminating this distinction should assist foreign investors in assessing the tax consequences of utilizing the three major forms of investment. In addition, the reductions in tax rates and the bolstering of regionally-based incentives make cooperative joint ventures and wholly foreign-owned enterprises more attractive vehicles for potentially high-profit ventures. For example, cooperative joint ventures earning more than 500,000 Renminbi ($135,000) annually will, if not eligible for any incentive benefits, be taxed at 30% or 33% instead of the current 35% to 50% progressive rates.

B. Increased Enforcement Efforts

The existence of tax evasion and tax avoidance has made the central government determined to strengthen the enforcement of the nation's tax laws. Chinese tax officials have frequently identified

enforcement as one of the major underlying problems with the current tax system. Among the solutions proposed to tighten enforcement are: an increase in the number and the level of training of tax agents; computerization of the border fiscal control system; and greater cooperation among Chinese authorities. In the latter case, for example, the State Administration for Industry and Commerce, the government organ which issues business licenses to many types of foreign investment projects, might work more closely with local and national tax authorities.

V. TAX ADMINISTRATION

Responsibility for the administration of China's tax laws rests primarily with the Ministry of Finance which initiates tax legislation and exercises overall control of the system. The law is administered through the various departments of the General Bureau of Taxation and delegates tax collection to the numerous local tax bureaus. The Bureau of Taxation has over 400,000 tax collectors throughout the country; this number is expected to grow to approximately 500,000.

As in many other countries, a substantial proportion of tax is collected by withholding income sources such as wages, dividends, interest, rents and royalties remitted abroad. Individuals residing in China, joint ventures and foreign enterprises established there, must file tax returns with their local tax bureau. The bureau calculates the amount of tax due and issues an assessment payable to the treasury. All taxes must be paid in Renminbi and late payments will be penalized.

In the case of a dispute the assessed tax first must be paid. Appeals against assessments are initially heard by the local tax bureau, with initial appeals going to the General Tax Bureau and to the Ministry of Finance. The local People's Court has jurisdiction over any further appeal. To date, there has been no reported case of a foreign individual or enterprise lodging such an appeal.

The absence of litigation may reflect, at least in part, a traditional Chinese preference for resolving disputes by mediation. More likely, however, it stems from the fact that Chinese tax legislation expressly gives a broad measure of discretion to local tax authorities, especially with regard to the granting of exemptions and privileges or the authorizing of alternative methods of computing profits. As a result, there is a tendency to regard the legislation as flexible guidelines to be used by the local tax bureau in negotiating disputes. Since those mat-

ters fall within the discretion of the bureau, there is no point in challenging an adverse decision.

The flexibility inherent in the Chinese system, the comparative lack of detail in the legislation, and the difference in practice from one city to another all give rise to a degree of uncertainty. This has provoked adverse reaction from some Western commentators. These laws, however, have been in existence for eight years or less. Gradually, the tax authorities are accumulating experience and common practices are being formulated and translated into the notices and interpretive rulings issued by the Ministry of Finance. These constitute an essential part of China's tax laws.

VI. CONCLUSIONS

Tax planning in China is difficult because the tax laws are vague compared to those in other countries. In the past, tax incentives alone have not motivated foreign investors to invest in China. Nonetheless, as China moves closer to the international norms of taxation, proper tax planning will become necessary. Considering that the Chinese tax system constitutes a part of the state-planned economy, tax policies adopted in China are bound to be different from Western countries. The emphasis placed on tax incentive programs and the success in negotiating tax treaties have demonstrated that the Chinese government is sensitive to foreign perceptions of the overall investment climate. Due to the lack of resources and trained personnel in China's tax system, it is likely that further improvement will be a gradual process. However, existing laws undoubtedly provide an adequate framework within which foreign investment can continue to take place.