

THE CHINESE TAX SYSTEM AND ITS EFFECTS IN THE DEVELOPMENT AND IN INTERNATIONAL TRADE RELATIONS OF CHINA: A JURIDICAL AND ECONOMIC APPROACH

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RESUMO:

Este trabalho apresenta o sistema tributário chinês e avalia seus efeitos no desenvolvimento e nas relações comerciais internacionais da China a partir de pontos de vista jurídico e econômico. Ele aborda temas importantes como o contexto da Constituição chinesa e do arranjo do sistema de base sobre a jurisdição fiscal da China e de partilha de receitas fiscais, bem como algumas questões gerais sobre a cobrança de impostos da China e sua gestão, descreve o atual sistema fiscal chinês e as questões relacionadas à reforma tributária. Ele também discute o papel da política fiscal no desenvolvimento econômico da China, considerando algumas questões importantes no processo de desenvolvimento econômico, e uma análise quantitativa detalhada sobre o fluxo de investimento externo na China é apresentado. Como uma parte importante da análise, introduz a história e o desenvolvimento da OMC, a entrada da China, o processo de reforma dos regimes de tributação chinesa, e os acordos internacionais de livre comércio que assinaram, os estão em negociação e aqueles sob investigação.

PALAVRAS-CHAVE: Sistema tributário chinês – comércio internacional – reformas tributárias – desenvolvimento econômico.

ABSTRACT:

This work introduces the Chinese tax system and assesses its effects in the development and in international trade relations of China from juridical and economic views. It discusses important themes like the context of Chinese constitution and the basic system arrangement about Chinese tax jurisdiction and tax revenue sharing as well as some general issues on Chinese tax collection and management, outlines the current Chinese tax system and describes related issues for tax reforms. It also discusses the role of tax policy in China's economic development by discussing some important issues in the process of economic development, and a detail quantitative analysis on external investment flow in China is presented. As an important part of the analysis, it introduces the history and development of WTO entry of China, the reforming process of the Chinese

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tariff regimes, and the Chinese international free trade agreements which have signed, are under negotiation and under research.

KEYWORDS: Chinese tax system – international trade relations – tax reforms – economic development

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1. Introduction

Tax system has been an important instrument of the Chinese government. The government not only relies on taxation as its main source of revenue, but also a “leverage” in “regulating” economic and social activities. To Chinese senior decision makers, taxation is often viewed as a powerful policy means to promote economic development and improve international trade relations.

This Chapter introduces the Chinese tax system and assesses its effects in the development and in international trade relations of China from juridical and economic views. Part II discusses some issues related on taxation in the context of Chinese constitution and introduces basic system arrangement about Chinese tax jurisdiction and tax revenue sharing as well as some general issues on Chinese tax collection and management. Part III outlines the current Chinese tax system and describes related issues for tax reforms. Parts IV discuss the role of tax policy in China’s economic development by discussing some important issues in the process of economic development. Part V gives a detail quantitative analysis on external investment flow in China. Part VI introduces the history and development of WTO entry of China, the reforming process of the Chinese tariff regimes, and the Chinese international free trade agreements which have signed, are under negotiation and under research. It also discusses the tax treaty and export tax rebate system in China.

2. Constitution and Tax System in China

2.1. Constitutional Structure

The current “Constitution of The People’s Republic of China” was adopted at the 5th Session of the 5th National People’s Congress and promulgated to become effective by the proclamation of the National People’s Congress on December 4, 1982. 31 amendments have been made in 1988, 1993, 1999 and 2004 respectively. The Chinese constitution of current version is divided into the following parts:

- the Preamble;
- Chapter I General Principles;
- Chapter II the Fundamental Rights and Duties of Citizens;
- Chapter III the Structure of the State;
- Chapter IV the National Flag, the National Anthem, the National Emblem and the Capital.

Under the current constitution, the provision directly related to taxation is only the 56th article, i.e. “It is duty of citizens of the People’s Republic of China to pay taxes in accordance with the law.” The legislative intent of this provision is clearly to emphasize the tax liability of citizens, rather than to establish legitimate principles of taxation and to protect the rights of taxpayers.

In addition, there are two articles used as a logical base for providing guidance with respect to protecting the property rights and human rights of citizens. These two articles are paragraph 1 in article 13, i.e. “The state protects the right of citizens to own lawfully earned income, savings, houses and other lawful property.”, and paragraph 3 in article 33, i.e. “The state respects and preserves human rights.”

As the constitution is the fundamental law in a country, to confirm the principles relating to taxation in the constitution must be the starting point to legalize tax law. Nevertheless, there is no clear response in the Chinese current constitution about the basic taxation principles, the basic system arrangement for public finance and taxation, the legislative division among different governmental levels, and the division of the central and local tax authority. These constitutional failures are undoubtedly disadvantageous to establish principles of taxing legitimately, to protect the rights of taxpayers as well as to push forward the process of construction of tax legislative in China.

2.2. Tax constitution

The Basic Tax Law is an extension of the spirit of the constitution in the fields of tax law. It can standardize tax legislation; tax administration and tax judicature to some extent, and thus improve the overall effect of the tax legal system and promote the achievement on the democratization and legalization of taxation. However, because of the constitutional failures mentioned above and little possibility to amend the constitution immediately, it is expected by the academics and the tax administrator to formulate a Basic Tax Law so as to partly resolve the problem.

Currently, there are two proposals concerning the legislative framework of the Basic Tax Law. One is drafted by the State Administration of Taxation; the other is drawn by experts who were commissioned by the National People’s Congress Financial and Economic Committee. Both of them covered the contents of tax legislation, tax administration, tax judicature and tax law interpretation, and considered the Basic Tax Law as a fundamental and comprehensive law. The difference between these two drafts is that, the former focuses on the maintenance of the effective implementation of taxing power; the latter emphasizes on the relief and protection of the rights of the taxpayer².

As a matter of fact, in the “Law of the People’s Republic of China on the Tax Collection and management” (hereinafter referred to as “Tax Collection and Management Law”), amended and implemented in 2001, there are dozens of rights for taxpayers, such as the right to be informed, to be kept privacy, to defense and to apply for tax refund. However, lots of scholars hope to make the relevant regulations on the rights of taxpayers in the Basic Tax Law, for the

² Tang Gongliang, Liu Shuang: “Review and outlook of the Basic Tax law”, *Taxation Research*, 2008 (1).

purpose of clarifying and protecting those rights in the higher level of law.

In the researches and discussions regarding the Basic Tax Law, there are a plenty of different views in terms of the scope of application, the basic principles of taxation, the division of the legislative power and other major aspects, therefore, the requirements for the Basic Tax Law to enter into the legislative process are not yet fully met. This is the reason why the Basic Tax Law was not included in the legislation plan conducted the 11th Standing Committee of the National People's Congress in 2009.

2.3. Tax jurisdiction and apportionment

At present, the tax revenues in China are collected by three government agencies: the tax authorities, customs authorities and finance authorities, just as shown in Table 1. Among them, the tax authorities include the State Administration of Taxation set up by the central government as well as two tax collection systems established at the provincial level and at the lower level, i.e. the national tax authorities and the local tax authorities. The national tax authorities are responsible for collecting central taxes and central-local shared taxes; the local tax authorities, by contrast, focus on the collection of the local taxes. The customs authorities mainly collect tariff, VAT and consumption tax occurred when importing. The finance authorities are in charge of the collection of farm land occupation tax and deed tax; these taxes, however, have been collected by tax authorities in some regions after the year 2000.

Table 1: The government agencies for collecting tax and their responsibilities

Government agencies		Responsibilities
Tax authorities	National tax authorities	Taxes belonging to central government (central taxes), Taxes shared by central and local government (shared taxes)
	Local tax authorities	Taxes belonging to local government (local taxes)
Customs authorities		Tariff Value added tax occurred when importing Consumption tax occurred when importing

Finance authorities	Farm Land Occupation Tax, Deed Tax (After the year 2000, these taxes have been collected by tax authorities in some regions.)
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During the period that from the opening-up reform to the tax-sharing system in 1994, the fiscal decentralization was being made. This led to an advantageous situation for the local governments in the distribution of national income. During this period, the fiscal revenue of central governments accounted for roughly 20% to 30% of the total fiscal revenue; the fiscal revenue of the local governments, whereas, took up as high as 70% to 80% of the total³. As a result, both the ratio of the fiscal revenue to GDP and the ratio of central government's fiscal revenue to the national fiscal revenue (referred to as "the two ratios") declined. In order to raise "the two ratios" and improve the fiscal capacity of central government, an important reform of the tax system occurred in 1994. As the largest-scale, the most extensive and the most profound reform since the founding of New China, it divided all taxes as central taxes, local taxes and central-local shared taxes between central government and local governments (including provinces, autonomous regions, municipalities and the cities of single plan). After the reform, the decline of "the two ratios" was stopped; the macro-control capacity of central government was accordingly strengthened.

Currently, the division of all kinds of taxes in China is as follows:

(1) Central taxes

- Consumption tax
- Vehicle Acquisition Tax
- Tariff
- Ship Tons of Tax imposed by customs
- Value Added Tax imposed by customs.

(2) Local taxes

- City Maintenance and Construction Tax
- Resource Tax
- Stamp Tax
- House Tax
- Urban and Township Land Use Tax
- Land Value Added Tax
- Vehicle and Vessel tax
- Deed Tax
- Farm Land Occupation Tax
- Tobacco Leaf Tax

³ Shang Tieli, Wang Na: "The Situation, embodiment and countermeasures about the vertical competition on taxation", *Taxation Research*, 2008 (10).

(3) Shared taxes

Shared tax and the specific share between central government and the local government are displayed in Table 2.

Table 2: Tax shared between central government and local government

Tax	Share of central government	Share of local government
Individual Income Tax	60%	40%
VAT	75%	25%
Enterprise Income Tax	60%	40%
Stamp tax(part of stock exchange)	97%	3%
Business tax	Business tax imposed on the Ministry of Railways, the bank's head office, head office of the insurance companies	The rest

Since 1994, there were several adjustments on the division of all types of taxes between central and local governments, and on the ratio of shared taxes as well. The effects of those adjustments show that there are mainly three problems of tax-sharing system:

1. An imbalance between financial powers and responsibilities.

In tax-sharing system, there is no corresponding division on rights of handling administrative affairs between local and central governments; the pattern of the division concerning routine power thus has not been changed. This leads to the fact that, most of financial resources has being obtained by central government (about 50% to 60% of the total fiscal revenues), by contrast, the responsibility of local governments on routine expenditures is much too heavy (nearly 70% of public expenditure taking place at or below the provincial level, of which more than 55% expenditures occurred in the cities, counties or villages).

2. A deterioration of fiscal difficulties at the level of grass-roots government.

The concentration of public finance at provincial and city level has been seen an increase, meanwhile the financial difficulties of counties and villages are

aggravated. In some regions, the transfer payments from higher levels of government have become the main source of the local governments' revenue. Nevertheless, the transfer payment system still exist many problems, such as overmuch special subsidy and overmuch counterpart funds, which weaken the function of transfer payment system to narrow the financial gap among regions.

3. Extra-budgetary fund has been regarded as the most important incremental revenues of local governments.

The land remise income is a main but informal sources of the revenue of local governments. This leads to the short-term behaviors of the government, corruption and the ineffective supervision on the budget.

2.4. General issues on tax collection and management

2.4.1. The legislative process on tax collection and management

For a long time since the founding of New China, the highly centralized and planned economic system was implemented; the fiscal revenue and expenditure are therefore centralized, so the government paid little attention to the building of the tax laws and regulations. The regulations of tax collection and management scattered among the separate laws and there was no uniform law and regulation on tax collection and management. In April 1986, in order to change the situation that the system of the tax collection and management was scattered, isolated and relatively conflicting, the State Council promulgated the "Provisional Regulations on Tax Collection and Management". This is the initial realization on the separation of the tax substantive law from procedural law in China; in addition, the prototype of the uniform legislation on tax collection and management was taken shape.

In September 1992, in order to resolve the problems that separate administration system for domestic and foreign-related tax, weak enforcement powers of the tax authorities and inadequate protection on the rights of taxpayers, the Seventh National People's Congress Standing Committee adopted the "Tax Collection and Management Law", according to the legislative principles that "strengthen tax collection and management, safeguard tax revenue and protect the legitimate rights and interests of taxpayers". Afterwards, there were two amendments in 1995 and 2001 respectively; it has become the basic law and regulation of tax authorities in respect of tax collection procedures.

2.4.2. Tax registration

According to the regulations, the main targets of tax registration are the units and individually-owned business engaged in the production and operating. The individuals (natural persons), state organs and the small traders in rural areas who have no fixed places for production and operating do not need to be tax-registered. According to the time and the content of registration, tax registration

is divided into three types, the registration of establishing, the registration of changing and the registration of cancelling.

The tax registration code is composed jointly and enforced uniformly by the state and local tax authorities, so although tax collection is divided into two authorities, there is no duplicate registration. In practice, according to “Tax Collection and Management Law”, industrial and commercial administrative organs should inform tax authorities about the situation of tax registrations and issuances of business license, however, there is inadequate communication between these two departments, leading to the problem that the number of industrial and commercial registration is greater than the number of tax registration.

2.4.3. Management on books, vouchers and invoices

According to the regulations, the tax authorities are responsible for administrating invoice, which involving management and supervision of its printing, receiving and buying, issuing, keeping and cancelling. In China, because VAT is a major source of tax revenue, in order to ensure the effective implementation of VAT credit system, whose key factor is the invoices, the security control network has been carried out with respect to the forgery of invoices and fraud of tax credits.

2.4.4. Methods on tax collection

In the case of having a sound financial accounting system and the ability of calculating tax payable accurately, a “checking accounting books” method can be used. That means the taxpayer declares the amount of tax payable by himself, fill in a special form after the verification of tax authorities, and then pay the tax to the designated banks. However, in the case of small enterprises with a inadequate financial system, a “specified amount” method is implemented. In addition to these two, other approaches, including “self-check, self-pay”, “withhold and pay” and “commissioned to levy tax” are available.

As a result of overmuch emphasis on the guidance of tax plan to the work of tax collection, some local tax authorities impose more tax than it should be, so as to achieve the tax plan. This kind of tax collection is no longer in accordance with the law. Currently, the analysis and evaluation on tax revenue as well as the monitoring of tax source is used to ensure the rationality of the tax plan.

2.4.5. Tax relief

According to the regulations, if there is a dispute between tax authorities and taxpayers, withholding agent or tax guarantors in the process of tax collecting, the tax payable must be paid according to the decision of the tax authorities, or

the tax as well as the fines must be transferred, or the related guarantee must be provided. Afterwards, the taxpayers, withholding agent or tax guarantors have to apply for the administrative reconsideration, and then appeal an administrative litigation if they are still unconvinced. Such a procedure will not only hinder the taxpayers to get the relief by legal means, but also increase the relief costs of the taxpayers. Due to the shortcomings in the design of such system and the long-term existence of the “authoritative” image of tax authorities, the taxpayers dare not to challenge the tax authorities face to face and thus few cases happened in reality that the taxpayers try to get relief by legal means.

2.4.6. Protection of the rights of taxpayers

For the purpose of setting up a administrative system with a public service-oriented government in China, the tax authorities as a public service department in government, is gradually changing the thought in the past that the government is a absolute “authority” and everything is firstly considered from the viewpoint of the government.

The conception of providing services to taxpayers is actively being established in China. A lot of specific performances of tax authorities to provide services for taxpayers are as follows: establishing Tax Service Office to provide a “one-stop” service to taxpayers; offering a variety of ways to declare tax e.g. by door to door visit, mail, telephone, internet etc.; setting up a national unified free hotline, i.e. 12366 which means 366 days or 12 month in a year, and websites specialized for tax service; newly founding a “tax-services division” in the State Administration of Taxation this year as well as special departments supplying full-time services for the taxpayers in the local tax bureaus. In the stage of tax paying and collecting, it has become practical actions that the tax authorities service to taxpayers and protect the rights of taxpayers.

2.4.7. Measures to safeguard tax collection

“Tax Collection and Management Law” and its detailed rules for implementation provide a series of measures to safeguard tax collection, including: tax preservation, mandatory enforcement, tax subrogation rights and revocation rights, restrictions on the departure abroad, etc. Tax preservation is implemented by tax authorities; mandatory enforcement could be carried out by both tax authorities and courts and mainly to business organizations; tax subrogation rights and revocation rights are exercised through the court proceedings; restrictions on the departure abroad generally should be decided by tax authorities and the implemented by public security organs. In addition, the living housing and daily necessities of taxpayers and their dependent family members are out of the scope of tax preservation and mandatory enforcement, which embodies the respect for basic human rights.

2.4.8. Penalties

Penalties can be divided into administrative penalties and criminal penalties. According to “Tax Collection and Management Law”, if taxpayers break the tax law, they will be punished, on the basis of administrative penalties, by the way of paying fine and forfeit or even being confiscated upon illegally income, etc. The procedure of tax administrative penalty includes a simple and a general one. The “Criminal Law” in China provides a number of tax-related crimes, mainly including two types of criminal acts: one is harmful to the tax collection; the other is jeopardized to the invoice management. The former includes several types, such as cheating the tax rebates on export, refusing to pay taxes, escaping paying tax arrears; the latter involves forging VAT invoices, faking VAT invoices, purchasing counterfeit VAT invoices, etc.

In February 2009, the Standing Committee of National People’s Congress decided in the “Criminal Law Amendment” to change the original “tax dodging crime” to “evading tax payment crime” and amended the specific provisions of the crime. Among them, the name of “tax dodging crime” seems to be not appropriate and is not in conformity with international practice; while after the change, the qualitative crime is more accurate. As for standards to convict, the original specific standard on taxes amount evaded is deleted, however the proportion which should be paid is reserved. This change adapts to the current economic and social development in China.

2.4.9. Informatization of tax collection and management

Since the late 1980s, the computer technology was first applied to the main fields of tax collection and management, and then in the local area network (LAN), finally to all aspects of administration of the tax authorities. Currently, the tax collection and management in China has changed from the traditional manual operation into a relatively advanced modern management based upon the informationization.

What is worth mentioning, the “Golden Tax Project” (GTP), promoted by the State Administration of Taxation and began in 1994, which is also called the Chinese Tax Management Information System (CTAS), is the key work in the informationization construction of tax administration. At present, both the first phase of GTP, called the Trail of VAT Computer Cross Audit System, and the second phase, which consists of Anti-counterfeiting Tax-Controlled Invoicing System, Anti-counterfeiting Tax-Controlled Authentication System, VAT Computer Cross Audit System and Invoice Investigation System, have been completed. The third phase was started in 2007, and the target is to construct a platform for the unified and standardized national application system, two levels centralized processing information of both state and provincial administration of taxation, three aspects covering all taxes, the important segments of tax work,

both the national and regional tax authorities and relevant departments, four systems consisting of collection and management system, the administrative management system, the decision supporting system, and external information exchange system. The third phase of the “Golden Tax Project” will have an important effect on full integration and extensive using of information resources, strengthening tax collection and management, optimization the tax service, improving the administrative efficiency, reducing the cost of taxation, promoting governance according to tax law, and ensuring of tax revenue.

2.4.10. Improvement and outlook on the “Tax Collection and Management Law”

The current “Tax Collection and Management Law” gradually exposes some problems incompatible with economic and social development which need to be improved.

2.4.10.1 Further confirming notions that the rights and obligations of both sides are equal and protecting the rights of taxpayers.

The main purpose of the current “Tax Collection and Management Law” tends to intensify tax authority and to ensure the realization of tax revenue. In order to meet the needs of safeguarding the rights and interests of taxpayers and establishing new relationships between tax authorities and taxpayers, the concept that both parties in taxation are equally important in tax law must be established. The exercise of administrative power by tax authorities must be under the restriction of taxpayer’s rights.

2.4.10.2 Improving the law articles concerning the protection the rights of taxpayers.

Although at present there are nearly 30 articles which involve protecting the taxpayers’ legal rights and offering service for taxpayers, they are dispersive and lack of wholeness and it is therefore hard for taxpayers to understand and grasp. So, these provisions need to be adjusted and integrated for taxpayer to complete understanding and mastering.

2.4.10.3 Coordinating with other laws.

Currently, there are some inconsistencies in “Tax Collection and Management Law” with the “Administrative Punishment Law”, the “Administrative Reconsideration Law” and the “Administrative Procedure Law” of China, for example, there is a difference of 75 days about the time limit on the decision to enforce for punishment between the “Tax Collection and Management Law” and the “Administrative Punishment Law”. In addition, after the amendments of the “Criminal Law” on the crime of tax evasion, the relevant content of the “Collection and Management Law” must also be revised accordingly.

2.4.10.4 Restricting the discretion of tax authority

There are some provisions in the “Tax Collection and Management Law” which authorize large discretion to the tax authorities and likely cause power abuse, corrupt, enforce unjustly, or impinge on taxpayers’ rights. For example, the 60th article of this law stated: “The taxpayer with one of the following conducts shall be ordered to make corrections within a time limit, by the tax authority, may be imposed a fine of not more than RMB 2000 Yuan; in the case of serious violation, be imposed a fine not less than RMB 2000 Yuan but not more than RMB 10,000 Yuan.” The word “May” in the article means that the tax authorities have the power to decide to impose a fine or not, and the chosen amount of the fine is over wide. Other similar provisions in the law need to be adjusted to limit the discretion of the tax authorities.

At present, the revision of the “Tax Collection and Management Law” has been included in the 5-year legislation plan conducted the 11th Standing Committee of the National People’s Congress.

3. Chinese Tax System

The current Chinese tax system is formed in 1994 and can be compartmentalized direct tax, indirect tax and others tax. Figure1 shows the increase trend of total tax revenue, Figure 2 shows the proportion of each part according to total data from 1994 to 2007, and figure 3 shows the proportion of each part according to annual data.⁴

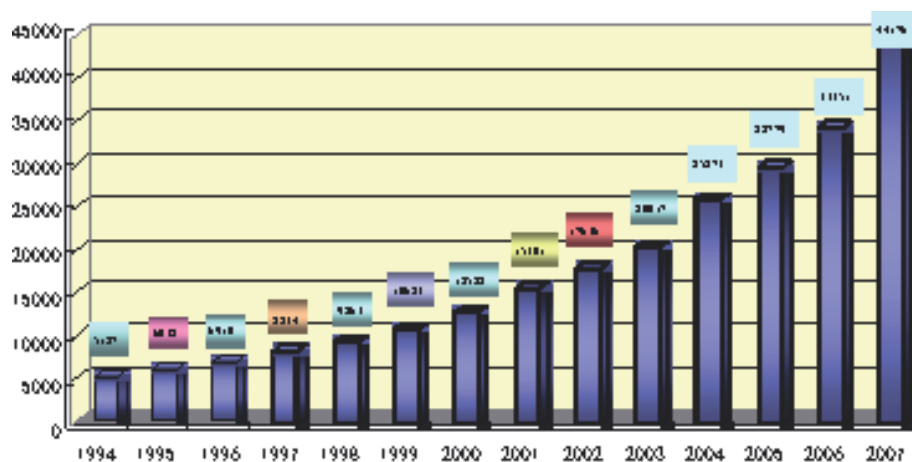


Figure 1: The increase trend of total tax revenue in China, 1994-2007

⁴ Direct tax includes enterprise income taxes, individual income tax, house tax, city and town land use tax, land value added tax and deed tax; indirect tax includes value added tax, consumption tax, business tax and resource tax.

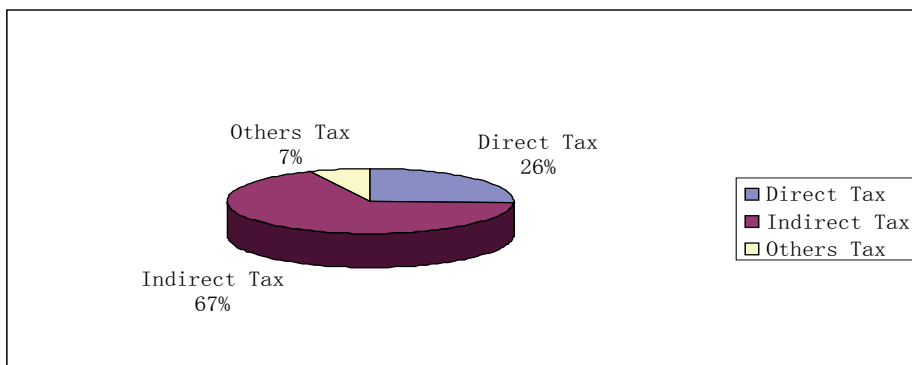


Figure2: The proportion of tax revenue in China, 1994-2007

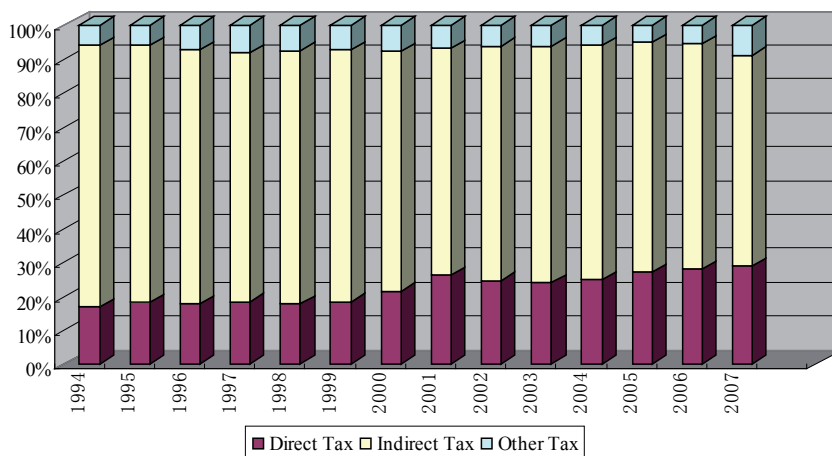


Figure 3: The annual proportion of tax revenue in China, 1994-2007

Source: Calculated by using the data from total data from 1994 to 2007 State Administration of Taxation and National Bureau of Statistics of China

<http://www.stats.gov.cn/> and <http://www.chinatax.gov.cn/n8136506/index.html>

3.1. Income Taxes

The income tax accounts for about 26.2% and 27.5% of total tax revenue in 2007 and 2008 respectively. The current Chinese income tax includes enterprise income tax and individual income tax.

3.1.1. Enterprise income tax

The establishment and improvement of Chinese enterprise income tax system can be divided into two aspects. Firstly, foreign enterprise income tax systems were established in the early year of 1980s and consolidated in 1991. In 1980 and 1981, the Income Tax on Chinese-Foreign Equity Joint Ventures and the Income Tax on Foreign Enterprises were implemented respectively. These two Income Taxes were merged into a consolidate income tax for enterprises with foreign investment and foreign enterprises in 1991.

For another aspect, domestic enterprise income tax system had been established and developed gradually. Since 1983, according to the nature of the enterprises' ownership, Chinese government promulgated and implemented the state-owned enterprise income tax, the collective enterprise income tax, the private enterprise income tax and the state-owned enterprise profit regulation tax. Meanwhile, based on the employees' bonus paid by enterprises and public institutions, Chinese government imposed three kinds of bonus tax respectively on the state-owned enterprises, the collective enterprises, and institutions too. This fragmented structure of the enterprise income tax system ended by the integrated domestic enterprise income tax in 1994.

From then to 2008, China has been existed two kinds of "domestic" and "foreign" enterprise income tax system. On the January 1, 2008, "Enterprise Income Tax Law" became into effect, which achieved completed unification in the income tax rate, methods and standards of tax deduction, tax preference and tax collection for both foreign-funded and domestic enterprises.

Enterprise income tax in China is collected yearly, but received in advance every quarter, the tax year is from Jan 1 to 31 Dec., any kinds of production or business income and other income shall be taxed. Although the principle of the tax is approximately the same as other countries, it also has its characteristic.

Firstly, taxpayer of enterprise income tax includes all the enterprises and other profit organizes in China. But individual proprietorship enterprise and partnership enterprise are not taxpayers of enterprise income tax, they are taxpayers of individual income tax.

Secondly, taxpayers are divided by register place and actual manage organization place into resident taxpayer and non-resident taxpayer. Resident taxpayers burden unlimited obligation of the tax, all the income of resident taxpayers, not only domestic income but also overseas income should be imposed on the tax. Nonresident taxpayer burden limited obligation of tax, only domestic income should be imposed on the tax.

Thirdly, the rate of enterprise income tax is 25%, but some enterprises enjoy preferential tax rates. Such as small-scale and low-profit enterprise enjoy 20% of tax rate; Enterprises advanced in technology and science which is

supported by the State enjoy 15% of tax rate.

Fourthly, the type of preferential treatments in enterprise income tax has been changed from region-oriented to industry-oriented in order to encourage technology innovation and investment, to sustain environment protection and to promote employment rate, etc.

3.1.2. Individual income tax

Individual income tax in China was established in 1980 and revised in 1993. The taxpayers include Chinese citizens, foreigners and compatriots from Hong Kong, Macao, and Taiwan who has income in China (includes people who have no nationalities). The most remarkable characteristic of Chinese individual income tax is that it is a classified income tax, not a comprehensive income tax. Under this kind of Chinese individual income tax system, all the taxable income is classified into 11 tax items, each has its tax rate and calculating method. The tax items and their tax rates can be seen from table below.

Table 3 Tax items and their tax rates of Individual income tax in China

Taxable item	Tax rate
1. Income from wages or salaries	ranging from 5% to 45% (see table 3)
2. Production or business income of individual industrial and commercial households	ranging from 5% to 35% (see table 4)
3. Business Income from contracted or leased enterprises	20%
4. Income from labor service	ranging from 20% to 40%
5. Income from remunerations to authors	14%

6. income from royalties 7. Income from interests, dividends and bonuses 8. Income from leasing of property, 9. Income from transfer of property 10. Accidental income 11. Other types of taxable income specified by the financial departments under the State Council.	20%
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Table 4 Individual Income tax rates (Applicable to wages or salaries)

Grade	Taxable income of the month	Tax rate (%)
1	Less than 500	5
2	The portion of income in excess of 500 to 2,000 Yuan	10
3	The portion of income in excess of 2,000 to 5,000 Yuan	15
4	The portion of income in excess of 5,000 to 20,000 Yuan	20
5	The portion of income in excess of 20,000 to 40,000 Yuan	25
6	The portion of income in excess of 40,000 to 60,000 Yuan	30
7	The portion of income in excess of 60,000 to 80,000 Yuan	35
8	The portion of income in excess of 80,000 to 100,000 Yuan	40
9	The portion of income in excess of 100,000 Yuan	45

Note: “The taxable income of the month” in this table refers to the amount of a monthly income after deduction of 2000 Yuan for living expenses or additional living expense deductions which is 2800 Yuan at present for foreigner who work in China Chinese people who work aboard and people come from Taiwan Hong Kong and Macao.

Table 5 Individual Income tax rates (Applicable to production or business income of individual industrial and commercial households, and business Income from contracted or leased enterprises)

Grade	Taxable income of the year	Rate(%)
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	Not exceeding 5,000 Yuan	5
1	The portion of income in excess of 5,000 to 10,000 Yuan	10
2	The portion of income in excess of 10,000 to 30,000 Yuan	20
3	The portion of income in excess of 30,000 to 50,000 Yuan	30
4	The portion of income in excess of 50,000 Yuan	35
5		

Note: The “taxable income of the year” in the table refers to the taxable income based on the gross income of a tax year after the deductions for costs, expenses and losses in accordance with the provisions of Article 6 of this Law.

Table 6 Individual income tax rates (Applicable to independent labor income)

Grade	Taxable income of once	Rate(%)
1	Not exceeding 20000 Yuan	20
2	The portion of income in excess of 20,000 to 50,000 Yuan	30
3	The portion of income in excess of 50,000	40

3.2. Property taxes

Property tax now in China are all local tax which includes house tax, land value-added tax, deed tax, Urban and Township Land Use Tax, and farm land occupation tax.

Table 7 The current property taxes in China

Tax	Tax object	Tax rate	Date of taking effect
House tax	Business house in cities, county towns, administrative towns, industry and mining districts	For self use: 1.2 For rent: 12	01/10/1986
Urban and Township Land Use Tax	Sate-owned land in the areas same as the above	See table 9	01/11/1988 01/01/2007 revised
Deed tax	Land and house acquisition of ownership	3-5	03/31/1950 1954 revised 1/10/1997 revised

Land value added tax	Transfer of real estate	30-60	01/01/1994
Farmland occupation tax	Occupation farm land to build house and engage in non-agricultural construction	5-50 Yuan/m ²	01/04/1987 01/01/2008 revised

3.2.1. House tax

House tax in China do not be collected in countryside, it shall be collected in cities, county towns, administrative towns and industrial and mining districts. The taxpayer is the owner of house used in business.

House tax has two kind of method of calculating. When the house is used in self production or business, its tax rate is 1.2% annually, the taxable value is the original house value reduced by 10~30% (determined by local governments). When the house is for rent, the tax rate is 12%, collect when receive rent, but if an individual rents his or her living house, the tax rate is 4%.

3.2.2. Land value added tax

Institutions and individuals with returns from the transfer of use right of state-owned land, buildings and other attachments thereon (hereinafter referred to as “realty transfer”) shall be payers of land value added tax. The amount of land value added shall be the balance of the income of a taxpayer from a realty transfer after deductions of items provided. For a real estate development enterprises, the deduction of item includes the payment obtained the right to use land, development cost ,development expenses, transfer taxes and fees, and an additional deduction which is 20% of the sum of the payment obtained the right to use land and the development cost.

Land value added tax shall be levied at progressive rates based on the rate of value added which is a quotient obtained from value added divided by total deduction amounts.

Table 8 Progressive rates of land value added tax

Grade	the rate of value added	Rate
1	not exceeding by 50%	30%
2	exceeding from 50% to 100%	40%
3	exceeding from 100% to 200%	50%
4	exceeding 200%	60%

3.2.3. Deed tax

An organization or person who obtains the right to use land or house in any legal means within the territory of the PRC shall pay the deed tax. The tax object does not include the transfer of operation right of the rural collective land. Rate of the deed tax is from 3% to 5%. Basis for calculating deed tax is transacted prices. The deed tax in nature is a real estate acquisition tax and a turn over tax. The real estate must be taxed when it is turned over and may be taxed repeatedly.

3.2.4. Urban and Township Land Use Tax

An organization or individual using land for production or business in cities, county towns and administrative towns and industrial and mining districts shall be a payer of Urban and Township Land Use Tax. This tax shall be assessed on a yearly basis and paid by installments, and determined by the provincial level governments. The annual tax amount of each square meters of land used shall be as follows:

Table 9 Rate of urban and township land use tax

Districts	Annual tax amount Yuan/ m ²)
Big cities	1.5-30
Medium-sized cities	1.2-24
Small cities	0.9-18
County towns, administrative towns and industrial and mining districts.	0.6-12

NOTE: The land use tax shall be levied according to the tax amount assessed on the basis of the actual area of the land used by a taxpayer in accordance with relevant regulations.

The people's governments of the provinces, autonomous regions and municipalities directly under the State Council shall determine a suitable tax amount range within the range of tax amount prescribed in the previous article and in light of the local urban construction and degree of economic development in the areas under their jurisdiction.

3.2.5. Farmland occupation tax

The farmland occupation tax applies to all state-owned and collectively-

owned farmlands. Farmland used for building house or engaging in non-agricultural construction shall be the object of this tax. The average tax amount per square meter for each province, autonomous region and municipality was determined by the State Council. Each province, autonomous region and municipality shall set the applicable tax amount differentially for each county(city) and suburb, but the average tax amount shall not be lower than the average tax amount specified regulations. This tax is a one time tax, not a periodical tax.

3.3. The reform issues of direct taxation

3.3.1. The reform of individual income tax

Reform of individual income tax is a pop topic in China now. In developed countries, individual income tax is a powerful tool in income redistribution, but in China, the revenue of individual income tax only is 7% of total tax revenue. Individual income tax in China is classified income tax, 11 items of individual income tax adopt different deduction and exemption amounts, different tax rates, different preferential measures. Only labor income and business income adopt progressive tax rate, others adopt proportion tax rate. Even though income from wages and salaries and income from labor service are all labor recompense, they have different methods of calculating. Besides, individual income tax doesn't consider family status of taxpayers (number of family members, health of family members, debt of family, and so on). There is a reform trend that the individual income tax system will be changed from its original classified system to a more comprehensive one.

3.3.2. Reform of real estate tax

At present, Chinese government will focus reconstruction of the real estate tax system on real estate maintenance, in other words, they will integrate current real estate taxes to levy a new real estate tax. The assumed real estate tax has some characteristics as follows:(a) the taxpayers shall be the units and individuals who owned or possessed real estate;(b) the tax base is the value of taxable real estate in its maintenance phase, and(c) the tax is calculated according to a certain percentage rate.

The main purposes of introducing the new real estate tax are as follows: (a) reform and improve the existing real estate tax; (b) adjust the income gap;(c) promote the local tax reform and (d)regulate the real estate market.

Since 2003 the State Administration of Taxation has began to carry out the assumed new real estate's assessment experiments simulation in 10 provinces and cities. From the decision-making level, it is imperative to introduce the tax, the matter is when to levy it. However, the introduction of this tax still has more difficulties, which embody as follows: (a) It is a great challenge for tax

authority to assess value of the real estate, that is, how to realize the objective to control collection cost fairly and effectively;(b) the property tax reform will involve many kinds of tax, and the coverage of integration involved widely, so it is necessary to take it full consideration;(c) Whether merging the revenue of transferred land into the tax base is not yet been in consensus; (d) If levy it on non-operating real estate of the individual, how to determine the scope and standards of collection is a problem. If the taxable scope is too broad and the taxable start point is too low, people will oppose it.

3.3.3. Inheritance tax (gift tax) issues

Inheritance tax is no stranger to China. After PRC was founded, the central government enacted the Principles for Implementation of the National Tax Policy in 1950, which include the article of inheritance tax. However, because of subsequent public-private partnerships and the implementation of the planned economy, there is nearly no private property to private citizens, inheritance tax had not been introduced. The tax reform listed inheritance tax as one of taxes preparing for introduction in 1994. In 1996, National People's Congress (NPC) of the PRC approved "The Ninth Five-Year Plan about national economic and social development and Long-Term Goals for 2010", in which, it said China will gradually introduce inheritance tax and gift tax." In recent years, with China's economic development, increase in personal wealth and income gap, the issue of inheritance tax once led to hot discussion.

Currently, to avoid excessive concentration of wealth and to regulate the gap between the rich and the poor in China, introduction of inheritance tax as an effective means is an inevitable trend under the background of building a harmonious society. In some sense, the introduction of inheritance tax has the economic base, but still facing some disadvantages, such as the concealment of property distributed of the high-income earners, weak administration abilities of the tax authorities, the difficulties of the heritage assessment and so on. Therefore, some relevance systems to support this tax must be established in advance, such as creating personal assets document management and the value evaluation system, designing system to prevent the transfer of personal property to the foreign effectively, avoiding capital flight after introduction of inheritance tax, etc.. Even the introduction of inheritance tax, at the early stage, tax authorities should also apply the way of narrow the tax base and low tax rates, then spread and improve them gradually.

3.4. Consumption taxes and other indirect taxes

Tax system in China is primarily based on indirect tax. The first three main indirect taxes in China are value added tax, consumption tax and business tax. Besides these, resource tax, city maintenance and construction tax and

education fee supplement also have character of indirect tax.

3.4. 1. Value added tax

Value added tax is the largest tax in China, the revenue of the tax exceeded 1.5 thousand billion Yuan in 2007, approximately 31% of the whole tax revenue of the year. China began to gradually put VAT in force in 1984 and revised in 1994 and 2008. An institution or individual engaged in selling and/or importing goods, providing processing, repair and/or replacements services within the territory of the PRC shall pay the value added tax. Besides processing, repair and/or replacement, other legal services are subject to Business Tax. The prescribed time limit for paying VAT shall be one month or one quarter or even one day. Though the principle of the tax is approximately the same as other countries, it also has its characteristic.

First, taxpayers are divided to general taxpayers and small-scale taxpayers. To a general taxpayer, the computer formula shall be: Tax payable = amount of tax on sales (tax is not included in the sales) - amount of tax on purchases (tax is not included in the purchases, generally the amount has been written in a VAT special invoice). A general taxpayer should have well accountant system, and its scale should exceed the standard. A simplified system of computation of tax payable shall be applied to small-scale taxpayers engaged in selling goods or taxable services. The VAT rate for small-scale taxpayers engaged in selling goods or taxable services shall be 3%. The amount of tax payable shall be computed by the following formula: The amount of tax payable = amount of sales (tax is not included in the sales) $\times$ tax rate.

Second, there are only two preferential rates of VAT. Besides 17% as the basic rate, the low rates subject to some goods are 13% and 0 (See table 10).

Third, only general taxpayers can apply and purchase VAT special invoice. When applying for deducting the input tax from the output tax, a taxpayer should go to tax authority for examining the VAT special invoice in ahead of time limit.

The production-type VAT had been implemented for more than 10 years. In 2004, Chinese government made experiment on implementing consumption-type VAT from old industrial districts in the northeast of China to the central region of China. In 2009, consumption-type VAT has been introduced all over the nation. The type transition of VAT ease the cash-flow pressure of the enterprises in the international financial crisis, which will benefit the enterprises get rid of the crisis.

Table 10 The value added tax rate in China

Taxpayer	Tax rate	Sphere of application
General taxpayers	Basic tax rate 17%	Goods' Selling or importing other than those listed below, and services of processing, repairs and replacement.
	Lower tax rate 13%	1. Agriculture, forestry, products of animal husbandry, aquatic products; 2. Edible vegetable oil and food grains duplicates; 3. Tap water, heating, cooling, hot air supplying, hot water, coal gas, liquefied petroleum gas, natural gas, methane gas, coal/charcoal products for household use; 4. Books, newspapers, magazines (excluding the newspapers and magazines distributed by the post department); 5. Feeds, chemical fertilizers, agricultural chemicals, Agricultural machinery and plastic covering film for farming; Etc.
	Zero tax rate	Exportation of goods (except otherwise stipulated by the State)
Small-scale taxpayers	3%	

3.4. 2. Consumption Tax

Consumption tax in China is different from other countries'. In China, consumption tax is a tax category and covers the 14 kinds of consumer goods. Some of object of consumption tax are unwholesome consumption goods, such as cigarettes, wine and alcohol; some are luxury consumption goods, such as valuable jewelry and gem and jade; some are excessive energy consumption goods, such as cars, motorcycle; others are can't reproducible, reused or replaceable consumption goods, such as oil.

The collection scope of consumption tax depends on the changes of consumption structure. In Dec 13, 1993, 11 specific items are covered by this tax. In Apr 1, 2006, the collection scope of consumption tax changes greatly, some goods are added, such as golf and golf tools, one-off wooden chopsticks; some goods are canceled, such as skin and hair care products; some are adjusted.

The consumption tax is a single stage tax which is collected only in one stage such as production, importation, subcontracting, processing, and retail sale(only for diamond and its gold and silver jewellery) This is different from value added tax and business tax, in which tax is collected in every stage when transaction is turnover. The rate of consumption tax has three forms, proportion tax rate, fixed amount tax rate and compound tax rate. Every taxable item, even different subdirectory in one item, has different tax rate.

Table 11 Items and rates of consumption tax in China

Taxable items	Tax rates (tax amount)
1. Tobacco	
(1)Cigarettes	
-Fixed tax amount	150 Yuan/standard box
-Proportional tax rate	
Grade A Cigarettes(price of a piece of cigarette $\geq$ 70 Yuan)	56%
Grade B Cigarettes (price of a piece of cigarette $\leq$ 70 Yuan)	36%
(2) Cigars	36%
(3) Cut tobacco	30%
2. Alcoholic drinks and alcohol	
(1) Chinese liquor made from grain and potatoes	
-Fixed tax amount	0.5 Yuan /500g
-Proportional tax rate	20%
(2) Yellow wine	240 Yuan/ton
(3) Beer	
-(Factory price/ton) $>$ 3000 Yuan	250 Yuan/ton
- (Factory price/ton) $<$ 3000 Yuan	220 Yuan /ton
Self-made by entertainment industry and catering	250 Yuan /ton
(4) Other alcoholic drinks	10%
(5) Alcohol	5%
3. Cosmetics	3%
4. Valuable jewelry, gem and jade	10%(5% for gold and silver jewellery)
5. Firecrackers and fireworks	15%
6.Refined oil	
- Unleaded gasoline	1.0 Yuan/litre

- Leaded gasoline	1.4 Yuan/litre
- Diesel oil, fuel oil, aviation kerosene	0.8 Yuan/litre
Naphtha, solvent oil, lubricating oil	1.0 Yuan/litre
7. Golf and instruments played golf	10%
8. Top-grade watches (The price of a watch $\geq$ 10000 Yuan)	20%
9. Barge	10%
10. One-off wooden chopsticks	5%
11. Solid wood flooring	5%
12. Automobile tyre	3%
13. Motor vehicle	
(1) The cylinder capacity > 250 ml	3%
(2) The cylinder capacity > 250 ml	1%
14. Car	
(1) Sedan car and Off-road vehicle	
- The cylinder capacity ≤ 1500 ml	1%
- $1500\text{ml} < \text{the cylinder capacity} \leq 2000\text{ml}$	5%
$2000\text{ml} < \text{the cylinder capacity} \leq 2500\text{ml}$	9%
$\square 2500\text{ml} < \text{the cylinder capacity} \leq 3000\text{ml}$	12%
$\square 3000\text{ml} < \text{the cylinder capacity} \leq 4000\text{ml}$	25%
$\square \text{The cylinder capacity} > 4000\text{ml}$	40%
(2) Light bus or station wagon	5%

3.4. 3. Business tax

An institution or individual engaged in providing taxable services, transferring intangible assets or selling immovable property within the territory of the PRC shall be a taxpayer of business tax. Business tax is collected by local taxation authority. It is the second largest indirect tax in China according to its proportion of the total of tax revenue. The proportion in 2007 and 2008 was 14.4% and 14% respectively.

Table 12 Items and rates of business tax in China

Taxable Items	Range of taxation	Rates
1. Transportation and communications	Shipment by land, water, air and/or pipeline, loading and unloading	3%
2. Building	Building, installation, repair, interior decoration and other building works	3%

3. Postal & telecommunications service		3%
4. Cultural and Sports service		3%
5. Entertainment	Singsong bars, ballrooms, karaoke lounges, discotheques, music teahouses, billiards clubs, golf clubs, bowling halls, and other amusement and entertainment facilities	5%~20%
6. Banking and insurance		5%
7. General service	Agencies, hotels, restaurants, travel agencies, warehouses, rentals, advertising agencies, and other service trade businesses	5%
8. Transfer of intangible assets	Transfer of land use right, patent right, non-patent technology, trade marks copyright, goodwill	5%
9. Selling immovable properties	Buildings and other constructions on land	5%

3.4. 4. Resource tax

Any institution or individual engaged in the exploitation of the mineral products or the production of salt within the territory of China shall be a taxpayer of resource tax. The amount of resource tax payable shall be assessed on the basis of the taxable volume of the taxable products and the prescribed unit of tax amount.

In the case of a taxpayer engaged in the exploitation or production of taxable products for sale, the sales volume shall be the taxable base. In the case of a taxpayer engaged in the exploitation or production of taxable products for self use, the volume for self use shall be the taxable base. An institution purchasing pre-tax mineral products shall be the withholder of this tax.

Table 13 Taxable items and range of tax amount of resource tax

Taxable Item	Range of Tax Amount
1. Crude oil	2—15 Yuan/1000m ³
2. Natural gas	0.3—5 Yuan/ton
3. Coal	0.5—20 Yuan/ton or m ³
4. Other non-medal ores	2—30 Yuan/ton

5. Ferrous ores	0.4—30 Yuan/ton
6. Non-ferrous ores	10—60 Yuan/ton
7. Salt	
Solid salt	2—10 Yuan/ton
Liquid salt	8—30 Yuan/ton

3.4. 5. City maintenance and construction tax

Any institution or individual liable to domestic VAT, domestic consumption tax and business tax shall be a payer of city maintenance and construction tax. It is an additional tax, because it has not its own tax base. The actual tax amount of the above three taxes is its calculation base. Three rates of city maintenance and construction tax are 7%, 5% and 1% which is applied for a taxpayer in a city, a county town or administrative town, and in other place respectively. It will be paid simultaneously when the above three taxes are paid.

The revenue from this tax shall be used exclusively and absolutely on the maintenance and construction of urban public utilities and services, and the concrete arrangements thereof shall be made by the local people's governments. But enterprises with foreign investment and foreign enterprises are not its taxpayers, imported goods also should not be collected this tax, exported goods should not be returned the tax.

3.5. General indirect taxation issues

Tax system in China is primarily based on indirect taxation system at present. This indirect taxation is powerful in ensure getting fiscal revenue and its agility and pertinence are unsurpassable by other taxes. But there are also some problems on Chinese indirect taxation system.

3.5. 1. The status of primary tax

Some scholars argued that primary tax system in China should be transferred gradually from indirect taxation system to direct taxation system. But actuality of China indicates that these are all not unpractical. Because direct taxation is difficult to collect and its taxpayers are difficult to manage, and its instability in getting finance revenue.

3.5. 2. The combination of value added tax and business tax

The coexistence of business tax and VAT is special phenomena in China. Generally, business tax and VAT are alternatively chosen in business turnover. A business operation should not be collected business tax and value added tax at the same time. The combination of VAT and business tax has been a serious public policy issue since 1994.

Many scholars think that the coexistence these two taxes have led many problems. Firstly, in practice, the borderline of the two taxes is not clear. So,

large numbers of especial regulations are established which make tax system become more and more complex. Secondly, generally, the whole sales turnover is the tax paying price in business tax, so iteration of collect and omit of collect occur frequently. Thirdly, a lot of enterprises have no habit of billing invoice, which get the collection of business tax be difficult.

The fundamental solution for this problem is to merge the VAT and business tax which all the transaction of goods and services are collected by a unified VAT. But there is no schedule to make the decision at present.

3.5. 3. The innovation of resource tax

Under the current resource tax, only mines and salt are involved, while many other natural resources are not involved, even some exiguity. This stimulates robbing of resources, so the prices of productions of resources are not reasonable. Resource tax is destroying the fairness of resource price.

Generally speaking, unit tax of resource tax is low. Some scholars think it's not good that the sales volume and the volume for self use as the taxable volume, because it stimulates enterprises and individuals exploit resource excessively, and reduces proportion of exploit again, get many resources which is difficult to exploit wasted and resources which is exploited but not sell or self use be overstock.

3.6. Other taxes contributions, fees, etc.

More than twenty taxes are contained in tax system of China, and there are also some contributions and fees which have character of tax. This section I will give a brief introduction of them.

3.6. 1. Stamp tax

All institutions and individuals signing contracts ,establish business booking or accept certificate for obtaining the right to use land and house,or business license, letter of patent, and trade mark paper within the Chinese territory shall be payers of stamp tax. Taxable contracts include of contracts of purchases and sales, processing, construction projects, lease of property, cargo shipment, storage and warehousing, loans, property insurance and technology transfers.

A taxpayer shall assess the amount of tax payable at different proportionate tax rates or by unit norms in the light of the nature of the contracts or certificates. Tax rate of stamp tax has two forms, proportional rate (generally 0.03%, 0.05% or 0.1%) and fixed-amount tax rate (5 Yuan). Stamps shall be affixed at the time of establishment or acceptance of a contractors or certificates.

3.6. 2. Vehicle and vessel tax

Institutions and individuals owning and using vehicles and/or vessels within the territory of the People's Republic of China shall be payers of the vehicle and vessel tax. The vehicle and vessel tax shall be levied by the local tax authorities where taxpayers reside on an annual basis.

Table 14 Tax amounts of vehicle and vessel tax

Type of vehicle or vessel	Norms for tax assessment	Annual tax amount	Note
passenger service vehicle	per	60-660	Include electric car
lorry, vehicle for special work	per dead weight tonnage	16-120	Include trailer or tractor
tricar, lorry with low velocity	per dead weight tonnage	24-120	
motorcycle	per	36-180	
vessel	per net tonnage	3-6	Tow and non-motor barge shall be tax at the half rate

3.6. 3. Vehicle acquisition tax

China's vehicle acquisition tax is formed in 2001 from an administrative fee collected by governmental vehicle supervision department for a long time. The scope of the Vehicle Acquisition Tax covers motor vehicles, motorcycles, trams, trailers and transportation vehicles for farm use. The tax collects at the purchase price of vehicle and rate of 10%. The car with less than 1.6 air displacement shall be tax at 5% at present. The taxpayers should pay the tax within 60 days after the day obtaining vehicles.

3.6. 4. Tobacco leaf tax

Purchasers of tobacco leaf from farmers are taxpayers of tobacco leaf tax. The amount of tobacco leaf tax payable shall be assessed on the basis of the purchase price and the rate of 20%. Tobacco leaf tax is collected by local taxation authority.

3.6. 5. Education fee supplement

Education fee supplement is very similar to the city maintenance and

construction tax on its levy base and payer but different on its uniform rate of 3% and fiscal use on improving educational facilities of basic and professional education.

3.6. 6. Social security fee

There are several social security fees in China. They are housing accumulation fund, work-related injury insurance, medical insurance premium, unemployment insurance premiums, endowment insurance and so on.

3.7. Taxation and electronic commerce

Electronic commerce is a new management form developing with informatization. There is no consensus in if it should be taxed in the world, and no country has systematic measures to collect tax from Electronic commerce.

In China, the first question which collecting tax from electronic commerce confront is tax registration. No legal identity on taxation administration means no tax collected. But if tax ministries want all taxpayers have legal tax registration, they should cooperate with business administration ministries. If there is no legal identity on business administration, taxpayer can't get legal identity on tax administration. But it's too difficult to constrain every taxpayer to get legal identity on business administration.

There is no electronic commerce tax regulation from the State Council in China. So the people's governments of the provinces, autonomous regions and municipalities directly under the State Council have different orders. The government of Peking ordered that all the units and people who engage in electronic commerce should get legal identity on business administration. But some local governments don't do like that, they encourage the development of electronic commerce, because it can help elevating employment rate and accelerating economic development.

4. Economic Development in China

In the past chapters, we focus on the taxation only. In fact, economic development and taxation is correlated closely. This part will analyze the impact of taxation on Chinese economic development.

4.1. Background

In the past 60 years, China has made great progresses in economy and society, but it is not plain sailing for the development.

After the establishment of People's Republic of China in 1949, for a long time inappropriate guidelines in economy and politic led to stagnation of economic and social development. For one thing, a strict Soviet-type command economy was put into practice and the private sector almost vanished in China.

Because command economy system made the whole country became a big factory, all resources became owned by government, and government command became the principle to assign all kinds of resources including lands, energy, even the people themselves.

This absolute government monopoly and control destroyed the rule of market, undermined the enterprises' and the people's enthusiasm in production. For another, in addition to the economic control, the government put more concern on the ideology struggles instead economic construction at that history period. All these blocked the economic development and in some sense even hampered the people's normal living, and in the end, it almost led economic system and society to completely collapse.

In view of this grim economic and political situation, at the crucial time in 1978, the leadership of Deng Xiaoping pointed out right direction of Chinese economic and political development, and then the Chinese government changed its policy emphasis from political struggle to economic development, and gradually let the market play its function of allocating resources. Moreover, President Deng made it clear that the need for giving priority to the development of economy. The economic reforms thus changed the relationship between the government and the market. The new economic policy included two main parts, one is opening up China to foreign investment, and the other is reforming the domestic economic system, the guidelines of which have continued to the present.

In detail, since the new economic policy introduced, it has mainly experienced three important development periods. The first period is from 1978 to 1984, the principle of priority to the development of economic development just introduced in this period. The second period is from 1984 to 1992, it was the exploratory phase to decide to take what patterns of economic development, as a result, the Chinese government chooses market as the basis principle to allocate resource, and establish the Chinese market economic system. The third period is from 1992 to now, during this period, Chinese government made a further improvement in market economic system.

Today, through many years development, Chinese has achieved great progress in economic and social development. The people's living conditions have been improved greatly.

4.2. Important issues

Chinese economy has experienced high rate of growth over last 30 years, meanwhile, its society has achieved a great development too. At present, how can we sustain the development is a problem the government and the researchers are concerned. Generally, now main three issues have been focused, which are related to economic growth, the inequality of income distribution and

the reform of state-owned enterprises.

The first important issue we will mention is about the transition of economic growth pattern. In the past 3 decades, there are three main driving forces leading to the economy rapid growth, among the factors, the growth of capital investment is the key factor of economic growth, moreover, technical progress, including upgrade of economic structure, improvement of human capital efficiency and institutional transition, contribute much as well. In addition, cheap laborers without more technique and knowledge are another factor to speed the economic growth. However, in a long run, the economic growth pattern is limited as that depends more on depletion of energy and lower marginal labor efficiency. According to the economic theory, the growth will be slowdown gradually because of constrains of energy, land, water supply and lack of effective labor forces. Therefore, in order to maintain a rapid and health economic growth, changing the pattern of economic growth will be a basic and necessary solution. Now how to realize the transition of economic growth pattern and what to do for transition are the important issues the government should face.

A second important issue is the inequality of income distribution. As we all seen, with the development of economy, Chinese income per person has risen a lot compared with the beginning of the reform and opening up for the world. However, accompanied by the steady growth of income, Chinese income distribution has changed dramatically as well. To ones depressing is the income gap not only exists between urban and rural areas, but also varies from the east district to the west and from person to person, what's worse is the income gap is widening rather than shortening with the economic growth, it means most people didn't enjoy the achievement of economic growth. If the trend of income distribution goes on, it may be produce unharmonious relation, and furthermore, it may be lead to the unbalance of politics and society.

Of course, equality and efficiency is a constant topic in human being's development course, sometimes the people will sacrifice part of equality to enhance efficiency, but sometimes the people will choose the opposite. Therefore, the inequality issue of income distribution is not unique issue for China, which also exists in the other nations, and currently, the key point to Chinese government reform is to provide the appropriate policies to get the balance between the equality and efficiency, and make the most of people can enjoy the achievements of the reform and economic growth. For this, the Chinese government is taking a series of policies, such as promoting the construction and completeness of the social security, creating more opportunity to employment, speeding the transition of recourse assignment pattern and so on, to shorten the income gap.

The third important issue in Chinese economic development is the reform of state-owned enterprises. From 1949 to the beginning of 1980s, state-owned enterprises was belonging to Chinese government, which themselves had nothing right to decide to what and how many should be produced not mention to decide the salary of the employers, all these were planned and decided by Chinese government. In some sense, they were only tools of government control rather than an independent body in market, the phenomena is an output of planned economic system. Until the past 30 years, the reform of state-owned enterprises has gotten a great progress after all. The obvious characteristic of the reform of state-owned enterprises in recent 30 years is the government has only implemented economic macro-control for the state-owned enterprises instead of the previous political interference, and let enterprises manage their own business. Recently the state-owned enterprises have gotten more freedom compared with before. They are developing towards modern enterprise system. However, the reform of state-owned enterprises has a long way to go as Chinese state-owned enterprises have their own unique characteristics. Until now, such controversial issues as whether the government should interfere the management of state-owned enterprises, what extent should be interfered, and how to interfere is under the exploratory phase.

4.3. Economic growth

Over the past three decades, China has experienced remarkable economic development. In 2005, China was the world's fourth largest economy measured by the size of the GDP, the third largest trader, and one of the largest recipients of foreign direct investment. The gross domestic product (GDP) grew from ¥364.5 billions in 1978 to ¥24.953 trillions in 2007. This section analyzes the volumes, the trends, and the related structure of GDP in China, focusing on the changes in GDP since 1994, when systematic reforms were set in motion.

4.3.1. The analysis on the absolute amount of GDP

According to the Three Step Development Strategy, which is China's overall economic construction objectives were clearly stated began since 1987, we can divided GDP's growth stage to three periods.

The first period belonged to Step One, which is to double the 1980 GNP and ensure that the people have enough food and clothing that was attained by the end of the 1980s. In the first period, we can see, at the beginning of reforming and opening up to the world, in 1978, China's total GDP was only 36.45 billion Yuan (RMB). After 8 years of hard work, in 1986, the first time Chinese total GDP reached to the level of 1 trillion Yuan (at current price). During this 8 years, average growth volume of GDP is fewer than 100 billion each year.

The second period belonged to Step Two, which is to quadruple the

1980 GNP by the end of the 20th century that was achieved in 1995 ahead of schedule. In this period, in 1991 Chinese total GDP rose to the level of 2 trillion Yuan (at current price), and average growth volume is more than 200 billion Yuan each year. Subsequently, the average growth volume is more than 1000 billion each year.

The third period belonged to Step Three, which is from the beginning of 21st century, aiming to increase per-capita GNP to the level of the medium-developed countries by the mid-21st century, in this period, by 2007, Chinese GDP rose to 24.95 trillion Yuan.

The above analysis shows that after systematic reforms, the GDP has shown appreciable increase (see Figure 4).

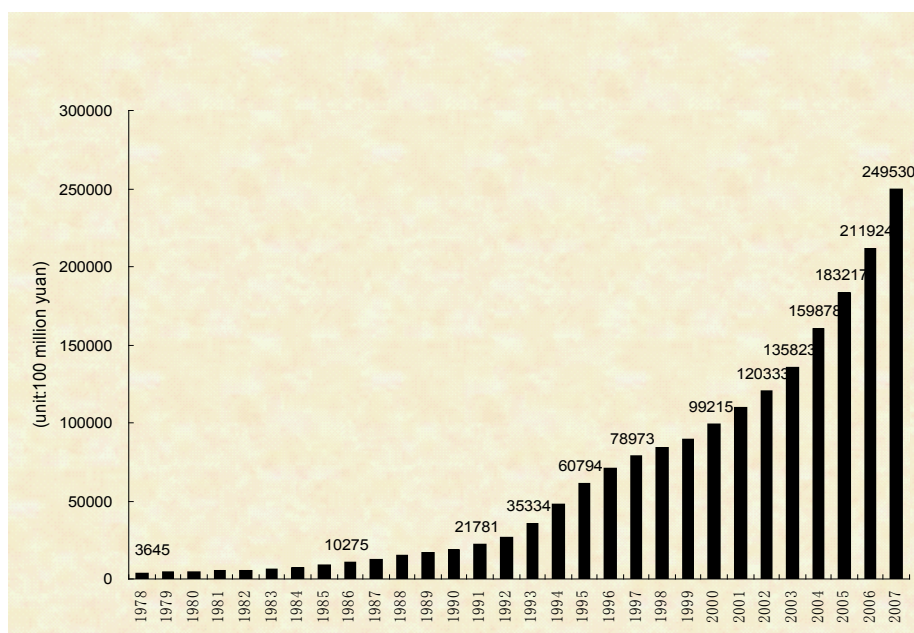


Figure 4: Total GDP 1978-2007, at current price)

Source: Calculated by using the data from Statistical Database of National Bureau of Statistics of China <http://www.stats.gov.cn/>

4.3.2. The analysis on the growth rate of GDP

As demonstrated in figure 5, in the past 3 decades, the growth rate of GDP has experienced periods from dramatic the fluctuant to the steady one, and the average growth rate of GDP has reached about 10 percent each year calculated by the constant price (see Figure 5).

The fluctuant period is from 1978 to 1993. From the Figure 4, we can see in this period, the fluctuant is obvious. In 1984, the growth rate of GDP reached about 15%, and arrived at the highest point at this period, the reason may be the implementation of the reform and opening-up policy led to the liberation of productivity. In 1990, the growth rate of GDP fell into the lowest point, after 1990, it began to rise again. The whole fluctuant period from 1978 to 1993 reflected the Chinese economy is in an adjusted phase, in fact, at that period, the Chinese government is groping for a suitable mode for Chinese economic system. Then in 1994, the Chinese government formally established the socialist market economic system.

Since 1994, Chinese economic growth rate gradually became steady. Although still had some fluctuation, we can see from the figure, the Chinese government's understanding to economic management was becoming completed. In 1994 and 1995, Chinese economic had the trend in inflation, so the government adopted the tight monetary and fiscal policies, which led to the drop of the growth rate of GDP. And in 1997, facing Asia Financial Crisis, Chinese government changed macro-control policy immediately, although the growth rate of GDP continued decline in the latter 2 years, Since 2000, the growth rate of GDP became positive again.

After 2000, the Chinese economic enter into steady developed period.

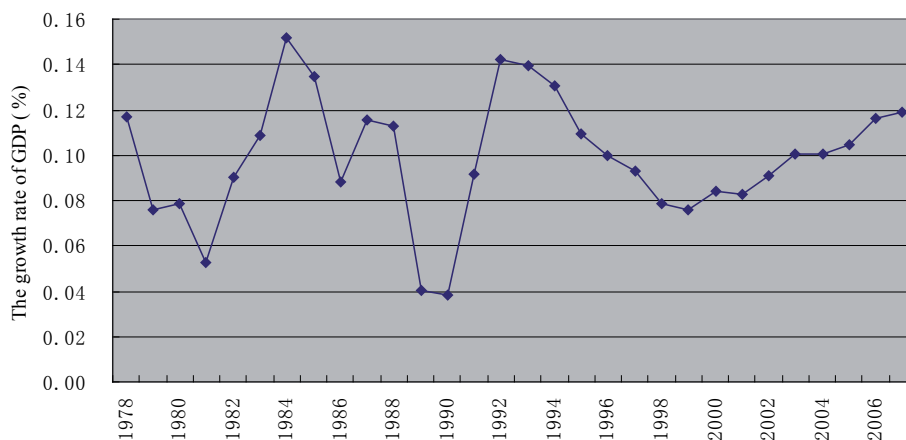


Figure 5: The growth rate of GDP in China 1978-2007 at constant price)

Source: Calculated by using the data from Statistical Database of National Bureau of Statistics of China <http://www.stats.gov.cn/>)

4.3.3. The analysis on per capita GDP

China's per capita GDP has also increased gradually. According to Statistical Database of National Bureau of Statistics of China, in 1978, China's per capita GDP is under \$300, to 1998, it exceeded \$800. In 2001, it increased to \$1000. In 2007, it is \$2461. The trend in per capita GDP is shown in figure 6.

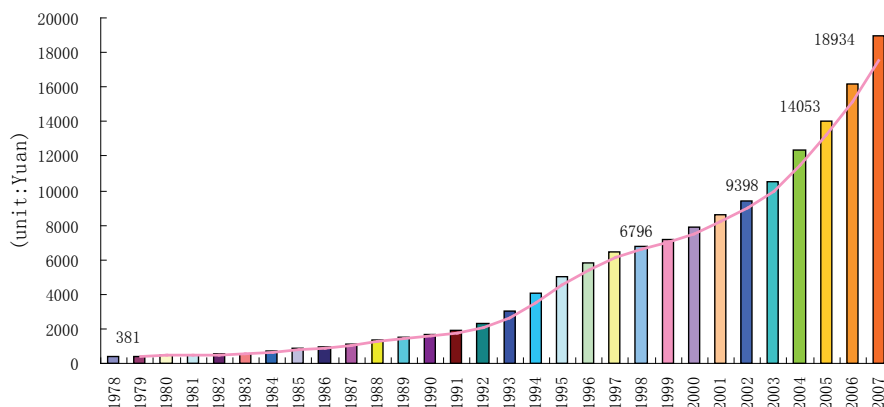


Figure 6: Per Capita GDP in China(1978-2007, at current price)

Source: Calculated by using the data from Statistical Database of National Bureau of Statistics of China <http://www.stats.gov.cn/>)

4.3.4. The Contribution of three strata of industry to GDP

4.3.4.1 The analysis on the structure of GDP (2007)

The total GDP comes from three strata of industry in China, which is primary industry and secondary industry and tertiary industry. The primary industry mainly refers to industry related to agriculture, forestry, animal husbandry and fishery, secondary industry mainly refers to industry related to mining, manufacturing, production and supply of electricity, gas and water, and construction, the left is tertiary industry.

Used the GDP data in 2007, we can see the primary industry's output value accounted for 11% GDP, secondary industry's output value accounted for 49% GDP and tertiary industry accounted for 40% GDP. Figure 7 shows the proportion of different industry by GDP. According to the statistics of National Bureau of Statistics in China, in 2007, contribution of the three strata of industry to GDP growth is as follows, primary industry's contribution is 0.4%, secondary industry's is 6.5%, and tertiary industry's is 5.1%, the total is 11.9% equaled to

the growth of GDP in 2007.

From these data, we can see clearly that the contribution of secondary industry and tertiary industry to GDP is bigger than primary industry, so in the coming future years, the Chinese government is planning to increase the tertiary industry's proportion in three strata of industry to GDP.

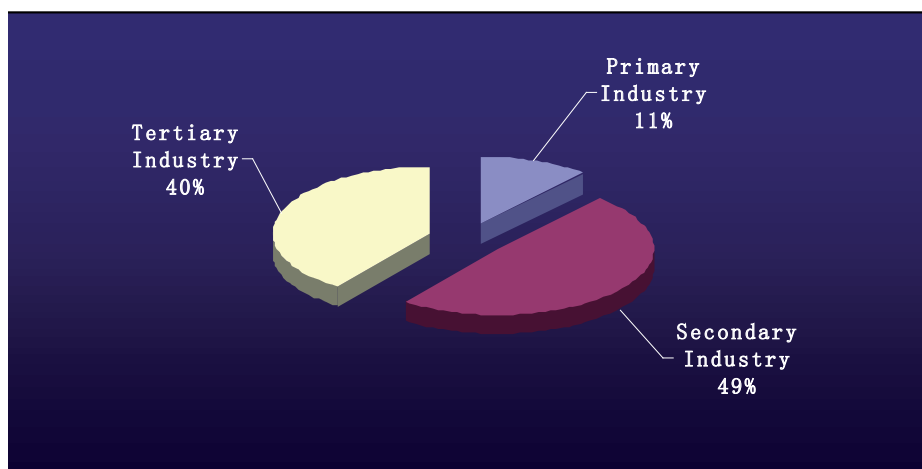


Figure 7: The structure of GDP in China, 1978-2007

a) Since 1980, the difference between the Gross Domestic Product and the Gross National Income (formerly, the Gross National Product) is the net factor income from the rest of the world; b) Data of the primary industry in 2005 and 2006 were adjusted according to the Second National Agricultural Census in 2006, data before 2004 were not adjusted. Source: Calculated by using the data from Statistical Database of National Bureau of Statistics in China, at <http://www.stats.gov.cn/tjsj/ndsj/2008/html/C0201e.htm>

4.3.4.2 The analysis on the growth rate of GDP by each industry (1978 to 2007)

The trend in terms of each industrial GDP's growth in China is slow growth for primary industry and rapid growth for secondary and tertiary industries. Figure 7 shows that growth rates for different industry.

From figure 8 depicts the growth in each industry is not well balanced. We should increase the growth rate of primary industry and tertiary industries to balance the various industries development.

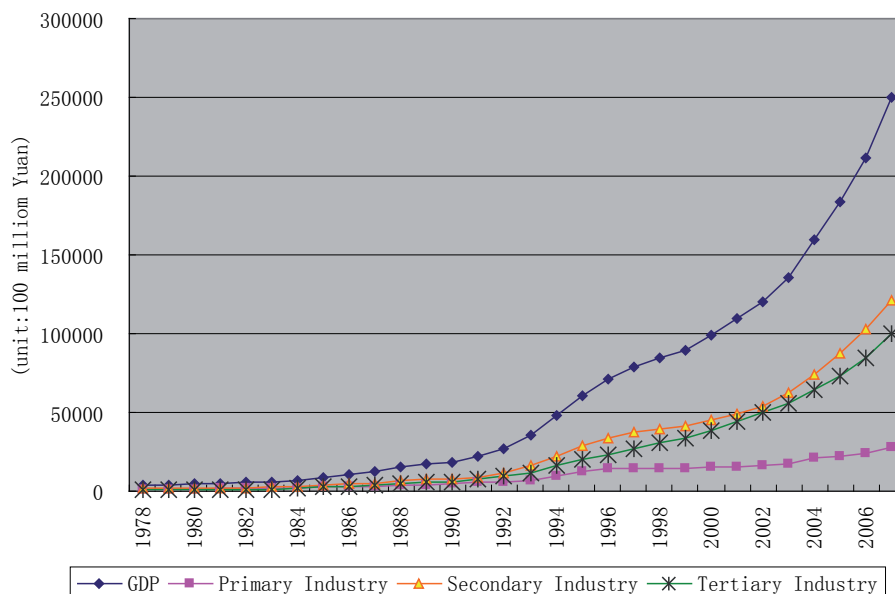


Figure 8: The trend in industrial GDP's growth in China, 1978-2007

Source: Same as Figure 5

4.4. How taxation affects the development process

4.4.1. The analysis on the growth rate and elasticity of GDP Taxation and GDP

The influence of tax on economic environment is complicated, and in turn, revenue growth is fuelled by economic growth. What's more, with the economy as the source of tax revenue, the revenue is fundamentally originated from GDP. Tax revenues are the outcome of government participation in primary GDP distribution and redistribution. Therefore, economic development and taxation is related closely.

From figure 9, we can see the trend in GDP and tax revenue. It is clear that taxation correlates with GDP, they have same trend. From 1994, the total tax revenue grown up or decreased with GDP. Moreover, the tax revenue increases faster than GDP. Compared direct tax revenue with indirect tax revenue, the former grows faster than the later. That is the direct tax has strong function of stability, it is on line with the economic theory.

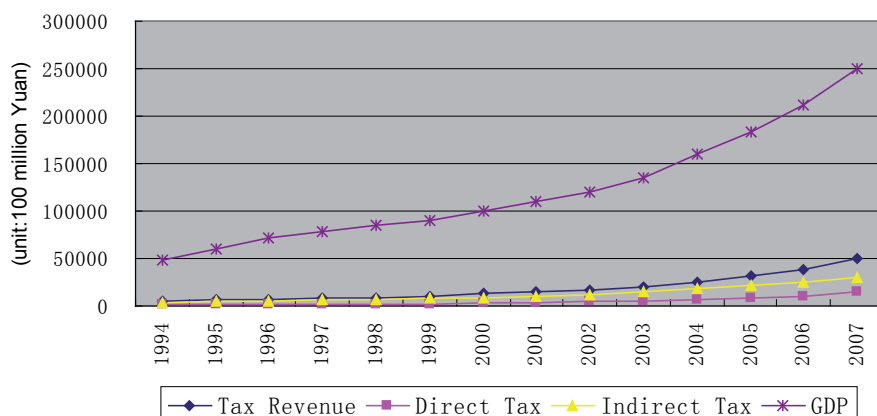


Figure 9: The trend of tax revenue and GDP in China, 1978-2007

Source: Calculated by using the data from State Administration of Taxation and National Bureau of Statistics and Statistical Database of National Bureau of Statistics of China, at <http://www.stats.gov.cn/> - <http://www.chinatax.gov.cn/n8136506/index.html>

In addition, tax revenue elasticity is an important aspect of tax policy. An elasticity of revenue that is no less than one indicates that the scale of tax revenue increases is at least the same as GDP. This implies a harmonious increase between tax revenue and GDP. If the elasticity is less than one, the scale of increase in revenue is less than that of GDP. This indicates a distortion in the relationship between tax revenue and economic development. The elasticity of China is almost above 1 and there is a steady balance change between tax revenue and GDP. Generally, the increase in tax revenue and GDP are consistent and harmonious. Table 15 shows the elasticity of tax revenue from 1995 to 2007.

Table 15: The elasticity of tax revenue in China(1995-2007) unit: %

Year	Growth rate				Elasticity		
	Total tax	Direct Tax	Indirect Tax	GDP	Total tax	Direct Tax	Indirect Tax
1995	17.8	25.9	16.0	26.1	0.7	1.0	0.6
1996	18.0	16.5	16.6	17.1	1.1	1.0	1.0
1997	16.7	20.2	14.3	11.0	1.5	1.8	1.3
1998	10.5	6.0	12.8	6.9	1.5	0.9	1.9

1999	13.4	18.5	12.3	6.2	2.2	3.0	2.0
2000	22.8	43.5	17.4	10.6	2.1	4.1	1.6
2001	19.7	45.0	13.5	10.5	1.9	4.3	1.3
2002	12.1	6.2	15.4	9.7	1.2	0.6	1.6
2003	20.4	17.7	21.4	12.9	1.6	1.4	1.7
2004	25.7	29.3	24.9	17.7	1.4	1.7	1.4
2005	20.0	30.8	17.4	14.6	1.4	2.1	1.2
2006	21.9	25.7	19.9	15.7	1.4	1.6	1.3
2007	31.4	36.0	22.8	17.7	1.8	2.0	1.3

Source: Same as Figure 9

4.4.2. The influence of taxation on the development process

From the analysis on the growth rate and elasticity of GDP Taxation and GDP, we can see Chinese taxation reform always related closely to the economic development process. When enhancing influence of taxation on the development process is larger than impairing influence, the taxation system keeps steady, or it will lead to reform. In this section, the analysis seeks to answer how taxation affects the development process.

4.4.2.1 *Impairing influence of taxation on the development process*

At firstly, the principle of tax reform is giving priority to efficiency, this lead to increase in external invest flow into China, and active the market. In some sense, the different tax reform in different phase is reasonable; however, when market becomes complete gradually, some problems emerge. Such as the income gap is too large, environmental pollution is serious, and high growth is dependent on high-energy consumption etc. then the previous tax policy will not well suitable for the needs of economic development, it should be change again. So, recent years China is beginning a new tax reform in order to maintain sustainable economic development. Maybe in near coming future, you will see a new tax reform to applying to new economic situation.

4.4.2.2 *Enhancing influence of taxation on the development process*

With transition from a planned economy to a market economy necessitated, Chinese tax reforms has obvious characteristics, which is gradual and pragmatic. At the beginning of the tax reform, in order to impel rapid development on economy, tax policy was driven by developmental features of the Chinese economy, i.e., transitional, favoring foreign direct investment, and regional disparities. It draws some preliminary conclusions about the negative impact of certain tax policies on economic development. Overall, the relationship is dynamic and mutually reactive□ and most of tax policies took positive effect on rise of economy in different phase .

5. External investment flow issues in China

5.1. Background knowledge

5.1.1. The coverage of external investment flow

In the past three decades, a huge number of external investments have been witnessed to flow into China and therefore have become one of the key elements for the comparatively rapid development of its economy.

Generally speaking, there are mainly two forms of external investment flows in China:

One is foreign direct investment⁵, which include five substantive types, i.e. equity joint ventures (EJV), contractual joint ventures (CJV), wholly foreign-owned enterprises (WFO), foreign share-holding companies (FS), and joint explorations (JE).

(1) Equity joint ventures involve joint investment by foreign and Chinese investors in limited liability corporations with sharing of profits/loses and risks.

(2) A contractual joint venture is a partnership between a foreign investor and a domestic enterprise. A typical example would be that the foreign partner provides technology (and sometimes a share of capital) and the Chinese side contributes the land, labor, physical facilities, materials, etc.

(3) Wholly foreign-owned enterprises, just as its name implies, are 100 percentage foreign investments.

(4) Foreign sharing-holding enterprises are a relatively new phenomenon. Its biggest feature is the shareholding of foreign shareholders should be more than 25% of the registered capital. Besides, there are some differences between foreign sharing-holding enterprises and equity joint ventures with respect to minimum limitation of registered capital, transfer of share, etc.

(5) Joint explorations mean that foreign and domestic cooperators jointly exploit petroleum either underground or in the sea.

The other foreign investments consist of shares issued to foreigners, international leasing, compensation trade and processing assembly.

Compensation trade is the form of countertrade in which an incoming investment is repaid from the revenues generated by that investment. Other three types of foreign investment are easily understood literally.

5.1.2. The development of enterprise income tax system in China

Tax system, size of market, cost of labor and natural resource, investment environment and entry barriers in one country are main factors to be taken into account by foreign investors.

The importance of tax system to external investment flows is quite different for different types of investors or in different countries. The taxation policies of China, especially those on corporation income, to some extent, have a considerable impact on external investment flows.

⁵ We only consider the actual utilization of FDI.

Generally speaking, income tax system for foreign-funded corporations in China has experienced roughly three stages:

5.1.2.1. The establishment of income tax system for foreign-invested corporations (1979 -1990)

Since the year 1978, as the implementation of its opening up policy to the outside world, China began to introduce the external investment by the way of establishing the Chinese-foreign equity joint ventures, Chinese-foreign contractual joint ventures and wholly foreign-owned enterprises. In order to meet the requirements of this new phenomenon, in 1980 and 1981 respectively, National People's Congress, the highest legislative organization in China, promulgated two tax laws one after another, namely "Income Tax Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures" and "Income Tax Law of the People's Republic of China on Foreign Enterprises". The latter was applicable to Chinese-foreign contractual joint ventures and wholly foreign-owned enterprises.

However, the encouragement of these two laws to external investments seemed not very notable. The comparatively high tax rates and certain discriminations in terms of preferential tax policies to contractual joint ventures and wholly foreign-owned enterprises were the main reasons.

5.1.2.2. The evolution of income tax system for foreign-invested corporations (1991-2007)

Due to the above-mentioned disadvantages of two laws, a new tax law for foreign-invested corporations, i.e. "Income Tax Law of the People's Republic of China on Foreign-investment and Foreign Enterprises", was issued in 1991. The significant characteristics of the new law were embodied in three aspects as follows:

(1) The integration of the tax policies for all kinds of foreign-invested enterprises, which removed the discriminated policies for Chinese-foreign contractual joint ventures and wholly foreign-owned enterprises.

(2) The reduction of the nominal tax rate on corporation income, which cut the highest marginal rate from 44% to 33%.

(3) The introduction of all kinds of tax incentives for foreign investments. These specially favorable policies, as far as geographic preference be concerned, aimed to improve the development in coastal regions⁶ because of their geographic advantage or close connection to overseas Chinese (who are living outside mainland China); and when it comes to the preference among different sectors in the economy, the tax incentives more supported farming, transportation and construction.

Compared with two old tax laws, the implementation of this one had

⁶ The coastal regions include twelve provinces, namely Beijing, Shanghai, Tianjin, Guangdong, Fujian, Liaoning, Hebei, Shandong, Jiangsu, Zhejiang, Guangxi and Hainan.

a much greater influence on the investment inflow from foreign countries. Nevertheless, the separation of income tax system for foreign-funded corporations from that for domestic enterprises brought about the unfair environment of competition, which thus caused the disadvantageous position of domestic corporations.

5.1.2.3 The integration of the income tax system for foreign-funded and domestic enterprises (2008-)

In order to create an impartial atmosphere, “Enterprise Income Tax Law of the People’s Republic of China” became into effect in 2008, which integrated the income tax system of foreign-funded corporations into that of domestic enterprises. In this new law, large amount of specially favorable policies only for foreign-invested companies previously have been eliminated and thus the actual tax rate applicable to them are in fact higher.

5.2.. The analyses on total volume of external investment flow

5.2.1. Vertical comparison

5.2.1.1 The analysis on the absolute amount of external investment flow

As it is showed in figure 10, in the past 30 years, the absolute amount of external investment flow in China has been increasingly growing. In 2008, the number was up to 96.255 billion US dollars, around 426 times of that in 1979. In different stages of income tax system for foreign-funded corporations, however, the increase of external investment flow had large differences.

In stage one, due to the two reasons we have mentioned above, there was only a slight growth from 0.226 to 3.755 billion US dollars.

On the contrary, it was seen a dramatic change in stage two. The external investment flow grew in a striking way from 4.666 billion US dollars in 1991 to its peak of 52.387 billion US dollars in 1997. After that, because of the influence of Asian Financial Crisis, the number fell until 2001. Since 2002, the inflow of investment continuously went up in a comparatively moderate way.

In third stage, i.e. in 2008, the obviously negative effect due to the eliminations of tax favorable policies for foreign-funded companies on the external investment flow did not show up. There was still a relatively large rise of 18 billion US dollars. This maybe either because the tax policy in China is not such a decisive element to be considered by foreign investors or the period of observation is not long enough.

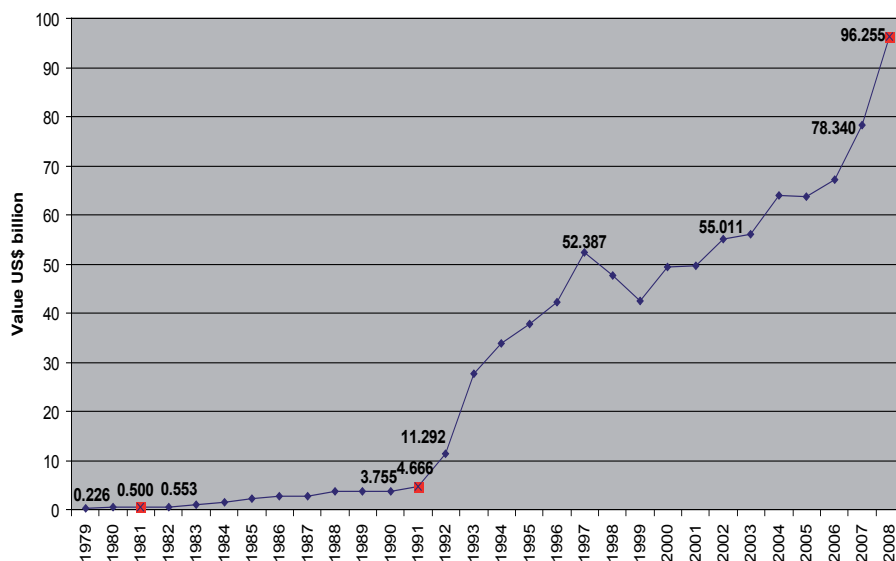


Figure 10: The absolute volume of external investment flow in China, 1979-2008⁷.

Source: China Statistical Yearbook, various issues. The website of Ministry of Commerce of the People's Republic of China

5.2.1.2 The analysis on the growth rate of external investment flow

As demonstrated in figure 11, the growth rate of external investment flow has several features as follows.

In stage one, the large changes of the growth rate was systematical, which means the variation in each year were comparatively big. Besides the relatively small influence of tax laws, this may be because of the insufficient understanding and resulting doubts of foreign investors concerning China's opening up policy.

In stage two, it has been seen an absolutely remarkable rise in 1992, which were primarily attribute to the implementation of many tax incentives in the new tax law. After the large decrease of the growth rate in 1994, that mainly was the result of the reform on value-added tax system, there was relatively gentle variation till 1997. As a result of Financial Crisis, the growth rate appeared negative in both 1998 and 1999. Afterwards, the growth rate became positive again in 2000 and changed in a mild way in the following years. This implied that external investment into China has been into a relatively steady period.

In 2008, the beginning of the stage three, it has been witnessed a gentle increase of the growth rate. The negative effect of the integration about the

⁷ The amount of other foreign investment in the year 2008 is an estimate.

income tax system for foreign-funded and domestic enterprises on the external investment flow did not show up as it would be predicted.

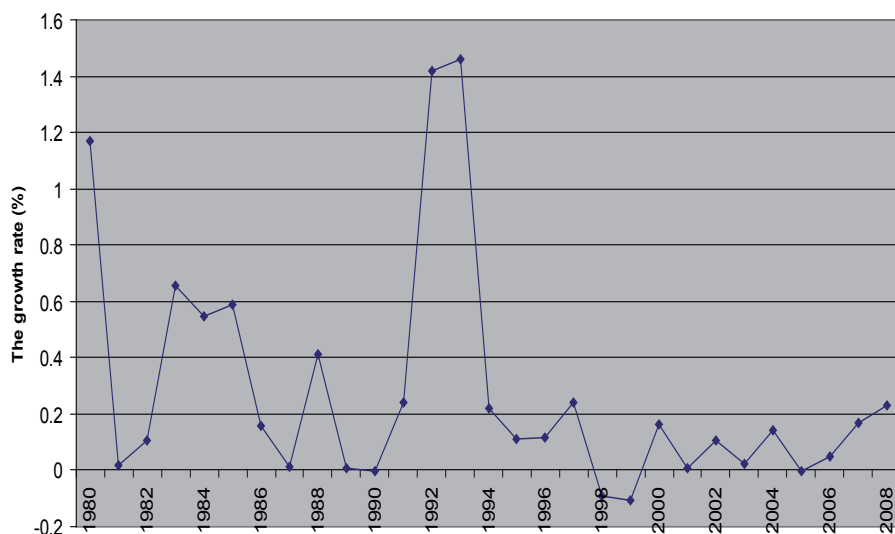


Figure 11: The growth rate of external investment flow in China, 1979-2008.

Source: China Statistical Yearbook, various issues. The website of Ministry of Commerce of the People's Republic of China

5.2.2. Horizontal comparison⁸

5.2.2.1 The analysis on the absolute amount of FDI

According to World Bank estimates of 2006 GNI per capita, China is classified as a lower-middle-income country⁹. Compared with other lower-middle-income countries, China attracted a large amount of foreign direct investment.

Just as illustrated by figure 12, the net inflows of FDI in China accounted for approximately one-third of total volume in all lower-middle-income countries in 1990. The number in 2000, however, rocketed to 71 percentages. Afterwards, due to the improvement of investment environments and other factors in other countries and meanwhile the rise of cost of labor and other resources in China, the proportion of China declined to 55 percentages in 2006. Nevertheless, the fact that more than half of FDI inflows in all lower-middle-income countries were allured into China still proved its great attractiveness as an investment location.

⁸ We here only consider FDI.

⁹ As for the coverage and standard of the lower-middle-income countries, please see Appendix one.

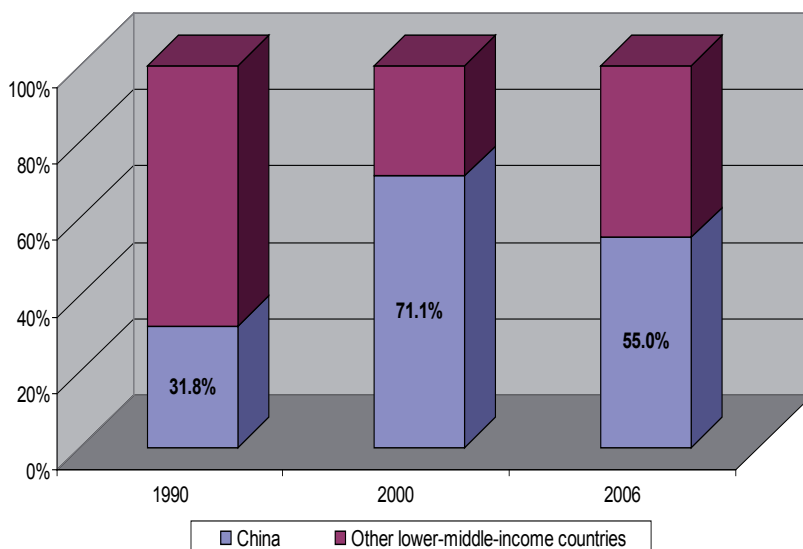


Figure 12: The proportions of the net inflows of FDI in China to that in other lower-middle-income countries, respectively in 1990, 2000 and 2006.
Source: Calculated by using the data from World Development Indicators 2008.

5.2.2.2 *The analysis on the ratio of FDI to GDP*

As far as the ratio of external investment flow to GDP, the numbers in China and other lower-middle-income countries were extremely close to each other in the year 1990 and 2006. This maybe reflect that, first, at late 1980s and early 1990s, FDI in the whole economy of China were as insignificant as that in other lower-middle-income countries; second, in comparison with previous years, recently other lower-middle-income countries have paid more attention on their attractiveness for foreign investors, e.g. adjusting tax policies and advancing infrastructure construction, the resulting FDI has been seen increasingly more. While, as the cost of production factors went up, the advantageous position of China has been weakened. Hence, respectively in 1990 and 2006, the ratio of FDI to GDP in China and other lower-middle-income countries were almost similar.

The reasons why there was such a high ratio of FDI to GDP in China in 2000, up to 3.204%, lay in the relatively lower cost of resources, more favorable tax policies in China on one hand, and the poorer investment environment in other lower-middle-income countries on the other hand.



Figure 13: The ratios of FDI to GDP in China vs. in other lower-middle-income countries, respectively in 1990, 2000 and 2006. Source: Calculated by using the data from World Development Indicators 2008.

5.3. The analyses on structures of FDI into China

5.3.1. FDI source countries

5.3.1.1 The analysis on main source countries or regions

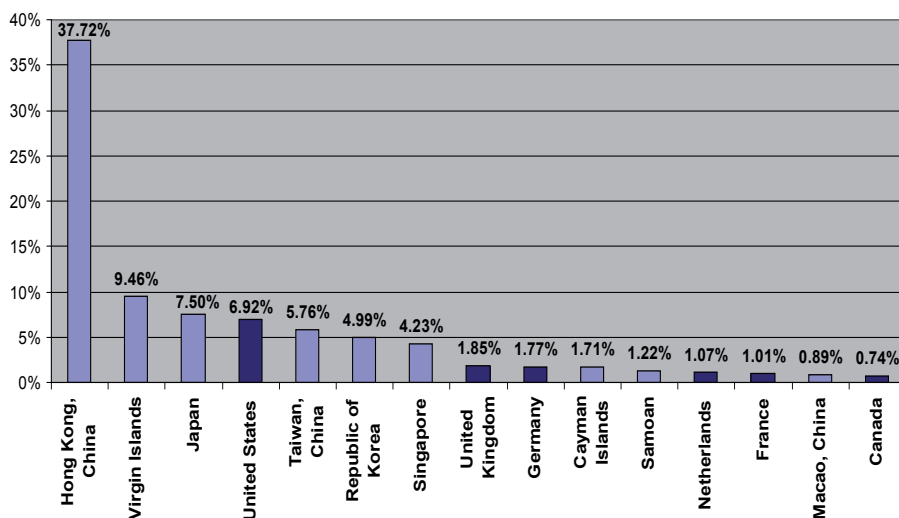
As displayed in figure 14, the top 15 FDI source countries or regions can be categorized as follows:

The first type is neighboring countries or regions, which include Hong Kong, Japan, Taiwan, South Korea, Singapore and Macao. With making up 61.09% of total FDI inflows in China, this kind of source countries, in particularly Hong Kong, is dominant on investment amount. Most FDI from Hong Kong, Taiwan, Singapore and Macao are to some extent attribute to the close connections to coastal regions of China, and heavily dependent to the tax incentives. FDI from Japan and South Korea, roughly 12.48% of the total volume, however, are mainly focus on the market size and consuming potential of China and therefore not very sensitive to the tax system.

FDI from Western Europe and North America consist of the second type, i.e. those in dark blue in figure 14, namely United States, United Kingdom, Germany, Netherlands, France and Canada. Since the vast majority of investments from these countries are in the form of multinational corporations, whose aim is the largest market and vital position of China in Asia, favorable tax

policies have very limited influence on them. However, the investment volume of these countries only accounts for 13.35% of total FDI inflows in China.

The third kind is those countries called “tax heaven”, including Virgin Islands, Cayman Islands and Samoan. Since the tax policies in these countries are abnormally favorable, e.g. zero tax rate on corporate income, the only goal of the companies set up in these countries is tax avoidance through preferential policies and shifting profits instead of doing real business, so the investments from these countries are poor-quality. What’s worthy noting is, up to 12.40% of total FDI in China derived from these countries.



Based upon the analyses above, the impression may be had that FDI inflow of China is not quite high-quality, a large part of which are sensitive to tax incentives and few of which merely emphasize on profit-shifting. Therefore, to improve the quality of FDI is crucial by eliminating some preferential tax treatments and regulating on transfer pricing. That’s one of important reasons why China carried out a new tax law in 2008.

Figure 14: The individual percentages of top 15 FDI source countries or regions, 1992-2007. Source: Calculated by using the data from China Statistical Yearbook, various issues.

5.3.1.2 The comparison between main source countries and other “BRIC” countries in terms of investment amount into China

In the figure 15, it is evident that foreign direct investments from

Russia, Brazil and India were much less than that from main source countries. During the period from 1992 to 2007, the total amounts from three countries only accounted for 0.35% of FDI from Hong Kong. This means, for one thing, the business between China and other “BRIC” countries was not active; for another, there is more space to cooperate among these countries.

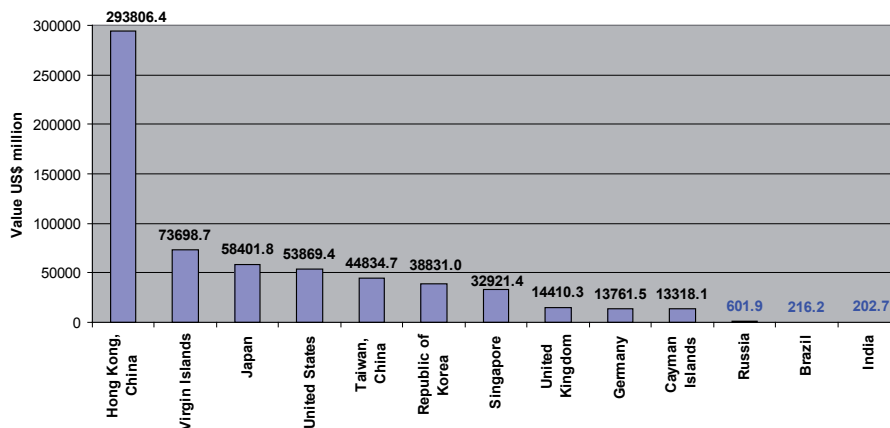


Figure 15: The FDI inflows from top 10 source countries and other “BRIC” countries, 1992-2007. Source: Calculated by using the data from China Statistical Yearbook, various issues.

5.3.2. FDI inflow in different regions in China

5.3.2.1. The analysis on the absolute amount of FDI in different regions

Just as demonstrated in figure 16, in terms of the absolute amount of FDI inflow, the differences between coastal regions and inland provinces became increasing larger, from 429 million US dollars in 1983 to 44156 million US dollars in 2004, nearly 90 times of that in 1983.

In stage one of income tax system for foreign-funded enterprises, i.e. before the year 1990, the gap among different regions on FDI was fairly small.

As the implementation of “Income Tax Law of the People’s Republic of China on Foreign-funded and Foreign Enterprises” in 1991, a large number of preferential tax treatments only for coastal provinces became effective, which largely resulted in the widening of the gap on the FDI between coastal regions and inland provinces.

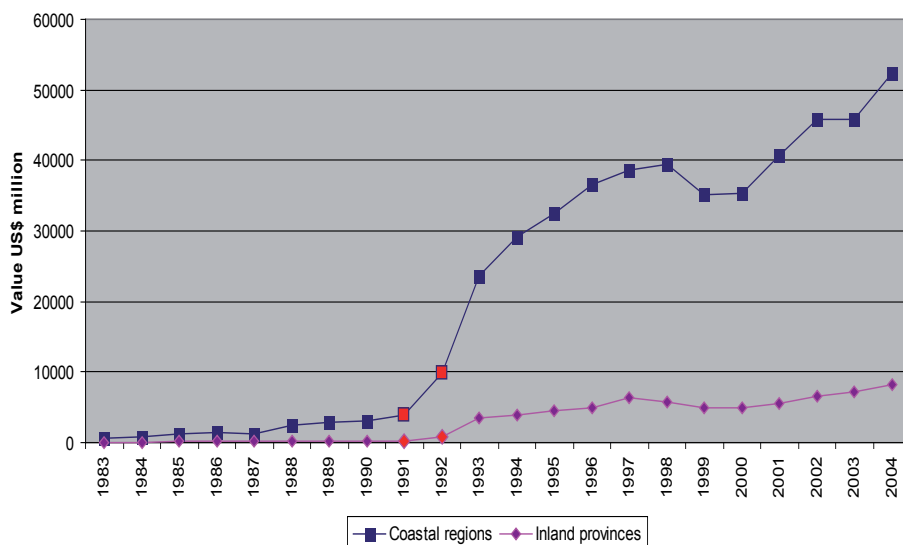


Figure 16: The amounts of FDI in coastal regions and inland provinces, 1983 -2004.

Source: Calculated by using the data from China Statistical Yearbook, various issues.

5.3.2.2 *The analysis on the percentage of FDI in different regions*

When it comes to the percentage of FDI in different regions, just as illustrated in the figure 17, the fluctuation was relatively big till the implementation of new tax law on foreign-invested company in 1991. Afterwards, FDI into coastal regions almost kept steady, making up around 88% of the total. This implied that, although there was an extraordinary increase of absolute amount of FDI in coastal regions since 1991; because of the larger base number in these provinces, as a matter of fact, the growth of FDI in coastal and inland provinces were almost proportional, there was no clear sign that the FDI into inland regions had deteriorated.

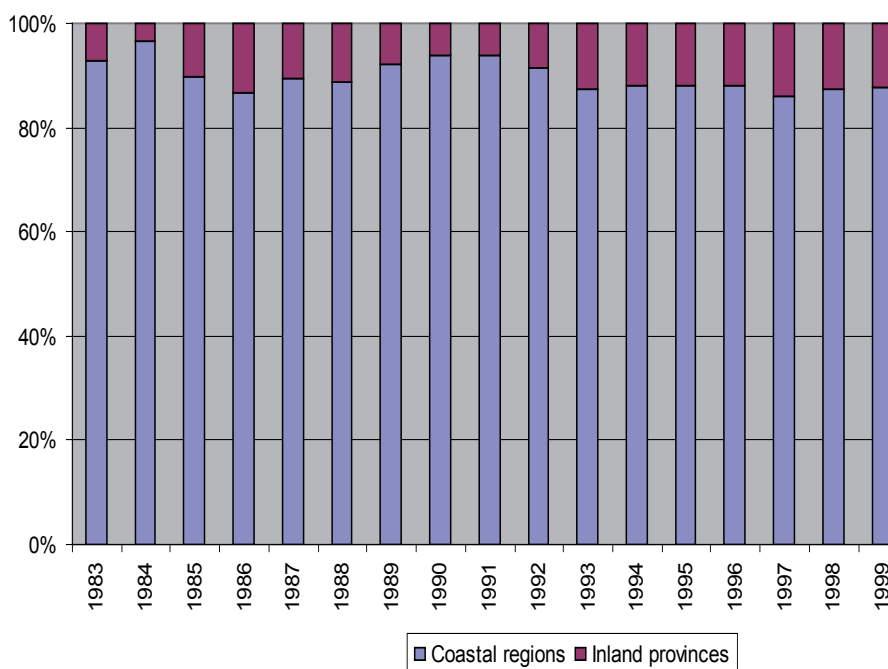


Figure 17: The percentage of FDI in coastal regions and inland provinces respectively, 1983 -2004. Source: Calculated by using the data from China Statistical Yearbook, various issues.

5.3.3. Different forms of FDI inflow

As mentioned at the beginning of this part, there are mainly five forms of FDI in China. During different period, as demonstrated in figure 18, the proportion of these differential forms differed.

In stage one of income tax system for foreign-funded enterprises, there were two subsections distinguished by dominant forms of FDI.

(1) From 1979 to 1985, joint explorations and contractual joint ventures were two major forms. For joint explorations, this was because the acquisition of natural resource, especially petroleum, is quite attractive for foreign investors and thus an easy way to alluring foreign investment at the beginning of opening up to outside. For contractual joint ventures, since the regulations on profit distribution, risk taking, the way of liquidation and so forth were comparatively flexible, it was easier to run such an enterprise.

(2) As the tax law granted more incentives for equity joint ventures, from 1987 to 1990, its proportion rapidly incrIn stage two, partly due to the

removal of some discriminated policies for wholly foreign-owned enterprises, it was seen an incredible growth of wholly foreign-owned enterprises in China, which accounted for 76.6% of all foreign direct investment in 2007.

On the contrary, the percentage of other forms of FDI declined with different degree.

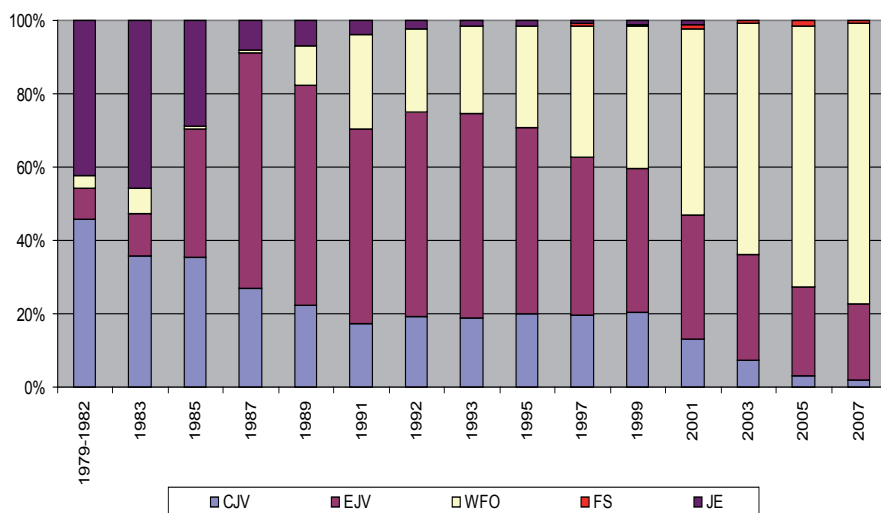


Figure 18: The percentage of different forms of FDI in China, 1979 -2007.

Source: Calculated by using the data from China Statistical Yearbook, various issues.

5.3.4. FDI inflow among different sectors in China

As mentioned before, the preferential tax policies in enterprise income tax law issued in 1991 were mainly in favor of farming, transportation and construction. Nevertheless, the great effect of this stimulus could not been seen clearly. As illustrated in figure 19, from 1991 to 2007, in comparison with the fluctuations in sector of manufacturing, there was no obvious growth with respect of the registered foreign-funded enterprises in above three “aim” sectors. This may be because those preferential tax policies on these sectors were not intense enough or tax system was not such a decisive element for investment decision.

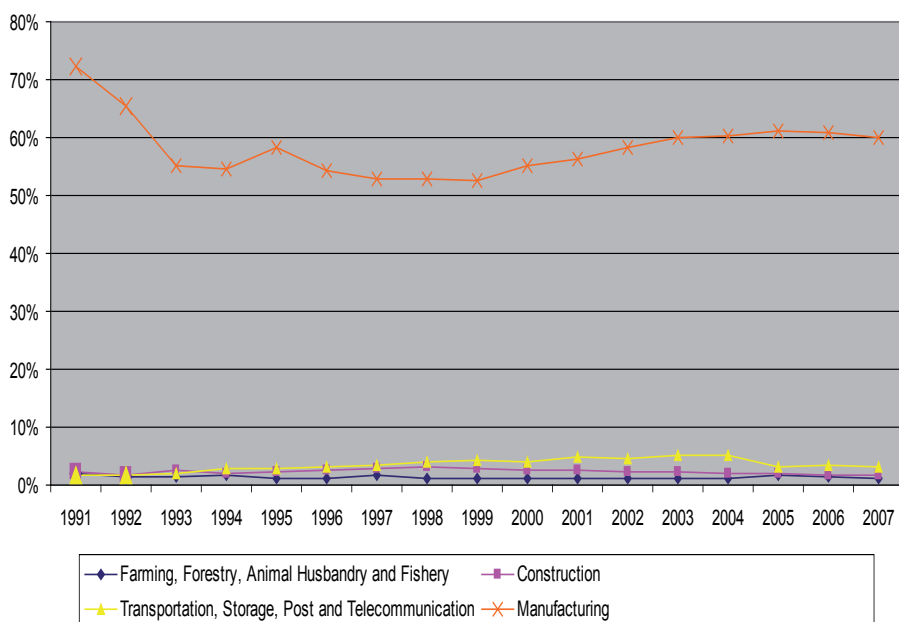


Figure 19: Registered foreign-funded enterprises by sector in China, 1991- 2007, the end of year. Source: Calculated by using the data from China Statistical Yearbook, various issues.

Appendix one: The coverage of lower-middle-income countries or regions

Lower middle income					
Albania	Cape Verde	Fiji	Kiribati	Paraguay	Tunisia
Algeria	China	Georgia	Lesotho	Peru	Turkmenistan
Angola	Colombia	Guatemala	Macedonia, FYR	Philippines	Ukraine
Armenia	Congo, Rep.	Guyana	Maldives	Samoa	Vanuatu
Azerbaijan	Cuba	Honduras	Marshall Islands	Sri Lanka	West Bank and Gaza
Belarus	Djibouti	Indonesia	Micronesia, Fed. Sts.	Suriname	
Bhutan	Dominican Republic	Iran, Islamic Rep.	Moldova	Swaziland	
Bolivia	Ecuador	Iraq	Morocco	Syrian Arab Republic	
Bosnia and Herzegovina	Egypt, Arab Rep.	Jamaica	Namibia	Thailand	
Cameroon	El Salvador	Jordan	Nicaragua	Tonga	

According to World Development Indicators, the lower-middle-income countries are those whose gross national income per capita is between \$906 and \$3,595. China's GNI per capita is around \$2,000.

6. International Trade of Goods and Services in China

6.1. WTO – history and developments

6.1.1. A brief history of China's accession to WTO

China was one of the 23 contracting states/parties to GATT (General Agreement on Tariffs and Trade). For the historical reason, China factually lost the membership in 1950.

In March, 1987, GATT set up a “Working Party on China” and China began the negotiation of resuming its GATT Contracting Party Status.

The founding of WTO in January 1995 transformed the negotiation course to acceding to the WTO.

Not until on November 10, 2001 did the Fourth Ministerial Conference of the WTO approve the law documents regarding China's accession to WTO, and subsequently China gained the formal membership of WTO.

6.1.2. Developments after accession to WTO

Since China's accession to WTO, the Chinese government has been fulfilling its commitments as follows.

In the first place, the law system under market economy has been perfected, and the openness of trading policies has been greatly improved. Since China's accession to WTO, the number of laws and regulations China made, revised and abolished have come up to more than 3000. The Chinese government has particularly set up the Bureau of WTO Notification and Enquiry of China which completely fulfilled its obligation of notifying China's trading policies and measures.

Secondly, the openness of goods trading market has been significantly improved and the trade rights been completely on the market. China's average tariff has dropped to the lowest within the promised range, and all non-tariff measures have been cancelled. In the light of “Foreign Trade Law” revised in April 2004, China fulfilled the promise of trade rights opening up half a year before the expected time, cancelling the 50-year-long system of trade rights approval.

Third, service trade has been gradually opening up in accordance with the promise. With regard to this field, a great majority, except the very few, will cancel restraints, allowing foreign sole investment and holding shares. Among the more than 160 service trade areas, China has opened up more than 100, taking up 62.5% which is close to the situation in developed countries. In such fields as bank, insurance, telecommunications, accounting and education, China strictly fulfilled its commitments, providing a large market.

Fourth, law enforcement of IPR (intellectual property Rights) protection has been greatly strengthened. This can find its way in two aspects of routine supervision coupled with particular management. The Chinese government

attaches significant importance to publicizing IPR protection and increasing the awareness of IPR protection. From 2004, China set annual April 20 to 26 as IPR week.

Fifth, China has been actively participating in making multilateral trading rules so as to prevent trade protectionism and ensure trade fairness. China takes the initiatives in participating in Doha Development Round and has put forward a lot of proposals and documents presenting China's stance. To promote mutual communications and diminish disagreement between different members, China has ever played an active and constructive role in the critical moment during negotiations.

6.2. Tariff policy and regimes

6.2.1. The reforming process of tariff regimes

Chronologically, the major phases of Customs regime construction are as follows:

First, 1985 saw the amendment of Regulations of the People's Republic of China on Import and Export Duties made in 1951, starting an all-round reform of tariff regime.

Second, 1987 saw the amendment of Regulations of the People's Republic of China on Import and Export Duties, on the basis of Customs Law, and the birth of Customs Tariff Commission of the State Council, which took full responsibility for formulating Customs policies and regime.

Third, in 1992, Customs Tariff Commission of the State Council amended Customs Tariff of Import and Export Commodities on the basis of the internationally acceptable HS (Harmonized Commodity Description and Coding System).

Fourth, in July, 2000, Customs Law was amended, adopting internationally acceptable Customs Valuation Codes stipulating that dutiable value of import and export commodities is decided by their purchase price. If the latter is uncertain, dutiable price is valued by the Customs. The same year also saw the amendment of Customs Tariff of Import and Export Commodities and formulation of Provisions of the Customs of the People's Republic of China for Assessment of Duty on Import and Export Goods.

Fifth, in November, 2001, the State Council passed Anti-dumping Regulations, Countervailing Regulations and Safeguard Measures Regulations.

Sixth, in October 2003, the State Council made another amendment to Regulations of the People's Republic of China on Import and Export Duties, which became effective on January 1st., 2004.

6.2.2. Implementation of Tariff Regimes

General Administration of Customs leads national Customs bodies and services, and on behalf of the state, is responsible for monitoring and managing Customs services, levying Customs duty, combating smuggling and protecting the state sovereignty and economic interest.

Customs levy duties on average imported commodities with duty rate as that of the most favored nations and graded tax reflecting the country's economic and trade policy. Export tariff is payable by only 35 individual commodities.

6.2.3. The Impact of WTO Entry on Tariff Regimes

6.2.3.1. China's commitments

According to the WTO regulations, its members are expected to cut down tariff level and promote free trade. China's commitments when entering WTO include:

- cancel export duties in principle.
- cut down Customs duties.
- ensure that all the laws, rules and measures related to origin rule are in full accordance with WTO Agreement on Rules of Origin and are implemented in a way that completely abides by such agreement.
- implement of WTO Customs Valuation Agreement in an all-round way.

3.2 Commitment fulfillment

China's general tariff level in 2001 was 15.3%, which was further reduced to 9.8% in 2009, among which, the average duty rate for farm products was still 15.2% and that for industrial products 8.9%.

With this tax reduction, China has met most of its tax-reducing commitments except for 5 commodities including fresh strawberry which has a one-year phase-out period.

Non-tariff measures have been cancelled ever since the January 1st, 2005. All the quota of products except wheat, dangerous chemicals and a small number of special commodities has been cancelled.

3.3 Anti-dumping and countervailing disputes

Anti-dumping, countervailing and safeguard measures are three protective means allowable by the WTO regulations to protect domestic industry and combat unfair trading practices in international trade.

However, some nations, out of trade protectionism, taking advantage of countervailing agreement and their own countervailing legislation, abuse countervailing investigation and take countervailing measures, posing negative effect on the international normal trade order. China was the saddest victim of anti-dumping. Meanwhile, countervailing has become another focus and field of trade friction in China, which has been the most frequently investigated country for countervailing. While China has been improving its legislation on anti-dumping and countervailing according to the WTO regulations, it is also

learning them actively to face up to such kind of trade issues.

6.3. International free trade agreements (FTAs)

6.3.1. The signed international FTAs

After China's accession to WTO, free trade zone has become a new form of China's opening up to the outside and a new channel to realize mutual benefits with other countries. The 17th National Congress of the Communist Party of China (NCCPC) clearly states that China will exercise the free trade strategy. Currently, China is building 14 free trade zones with 29 countries and regions, accounting for 1/4 of China's total foreign trade. According to the statistics by the Commerce Ministry of PR China, China has signed 8 FTAs with other countries and regions ¹⁰.

6.3.1.1. CEPA (Closer Economic Partnership Arrangement)

In order to promote economic mutual prosperity and development between Mainland China and Hong Kong and Macao China, the central government signed CEPA with Hong Kong and Macao on June 29, 2003 and October 17, 2003 respectively. Meanwhile, six supplementary agreements were signed chiefly including three aspects: zero tariff on cargo trade, enlarge the market admittance of service trade and improve the convenience of trade and investment.

6.3.1.2. China-ASEAN FTA

On October, 2003, China joined the Treaty of Amity and Cooperation in Southeast Asia, becoming the first non-ASEAN country. China-ASEAN Free Trade Area is the first and so far biggest free trade area with other countries. The members includes China and 10 ASEAN members, concerning as large as 1.85 billion people and 14 million square kilometers. Currently, ASEAN is China's biggest trade partner among developing countries and China is ASEAN's No.4 trade partner. By January 1, 2007, China's average tariff on ASEAN has dropped to 5.8% and 2.4% by January 1 this year. China-ASEAN trade area will have been completely built up by 2010 when 93% of China's imported products from ASEAN will enjoy zero tariffs.

6.3.1.3. China-Chile FTA

China-Chile FTA is the first trade agreement China signed with Latin American countries. Since October 1, 2006, the Agreement has been brought into force. China favors zero tariffs to 2834 imported products from Chile including metals, non-metal mineral products and most primary products from nonferrous metals. In the meantime, Chile gives preferential zero tariff to 5891 imported products from China including vegetables, fruits, most machinery and electrical equipment. 97% of the trading products between the two countries will realize zero tariffs within the next 10 years.

¹⁰ Please see: http://fta.mofcom.gov.cn/cepa/cepa_jianjie.shtml.

6.3.1.4. *China-Pakistan FTA*

The agreement was signed and brought into force on November 24, 2006. In line with the agreement, China and Pakistan will cut down tariff on all goods in two steps. One is that in the five years following the agreement taking effect, the two parties shall cut down the tariff on different scale on their respective 85% tariff items. Among that, 36% product tariff shall be cut down to zero within three years. The other step is that from the sixth year after the agreement was in effect, the two parties shall further lower tariff, and the final aim is to make the number of products and tariff items, on both sides, enjoying zero tariff reach 90%.

6.3.1.5. *China-New Zealand FTA*

The agreement was signed on April 4, 2008. This is the first FTA that China has ever signed with developed country. In 2007, the bilateral trade between China and New Zealand reached 3.7 billion US dollars, increasing of 26% year-on-year. China has become the third largest trading partner, the fourth largest exporting market and the second largest importing source country, of New Zealand.

6.3.1.6. *China-Singapore FTA*

The agreement was put into practice from January, 2009. According to the agreement, Singapore shall cancel the entire tariff on the products imported from China from January 1, 2009. China, before January 1, 2012, shall cut off 97.1% of the tariff on the products imported from Singapore, among which 87.5% of the products from Singapore shall enjoy zero tariff from the moment when the agreement takes effect.

6.3.1.7. *Asia-Pacific Trade Agreement*

The population of the member countries of Asia-Pacific Agreement has reached 2.4 billion, taking up approximately 40% of the world population. The original name of the agreement was Bangkok Agreement. China became the formal member of the agreement on May 23, 2001. The name was changed into Asia-Pacific Agreement at the First Ministerial Council held in Beijing, November 2005. It was agreed at that council that the members shall exercise the third round tariff concession from 2006. The fourth round negotiation concerning tariff concession is being conducted currently.

6.3.1.8. *China-Peru FTA*

On April 28, 2009, the Chinese government and Peru government signed China-Peru FTA. This was the first package free trade agreement that China assigned with Latin American countries. According to this agreement, in cargo trade the two parties shall offer, in different phases, zero tariffs on over 90% of their own products. In service trade, the two parties shall further open markets on the basis of their commitments to WTO. In investment, the two parties shall offer the investors and the investment of the other party national treatment after

entry permission, most-favored nation treatment, and fair and just treatment, encouraging bilateral investment which will be offered convenience.

6.3.2. FTA under negotiations

6.3.2.1. China-GCC (*Gulf Cooperation Council*)

In July, 2004 China and GCC signed China-GCC Cooperation Framework Agreement on economy, trade, investment and technology. In the meantime, the two parties announced to initiate FTA negotiation between China and GCC. The negotiation has gone through five rounds. The two sides have reached agreements in most fields of cargo trade, and have started service trade negotiation.

6.3.2.2. China-Australia

On April 18, 2005, China and Australia signed the memorandum of understanding in Beijing that initiated FTA negotiation between the People's Republic of China and Australia. Since then thirteen rounds of negotiations have been conducted. The 13th round negotiation was held in Beijing, December 2008. The two parties furthered the discussions about the framework of FTA, market entry permission of cargo trade, professional services, financial services, educational services, intellectual property and investment and so on.

6.3.2.3. China-Iceland

The first round negotiation was conducted in April 2007, and four rounds have been through so far. The two parties deeply exchanged views on the topics related to China-Iceland FTA, including tariff reduction model, primary origin of production, SPS/TBT, cargo trade, service trade, investment, economic cooperation and agreement texts. The negotiations have made positive progress.

6.3.2.4. China-Norway

The first round free trade area negotiation between China and Norway was conducted on September 18, 2008. So far, four rounds have been through. The two parties exchanged views on cargo trade, service trade, investment, primary origin of production, SPS/TBT, trade convenience, dispute solving, trade remedy and intellectual property, etc.

6.3.2.5. China-SACU (*Southern African Customs Union*)

China-SACU FTA evolved from China-South Africa FTA. The FTA negotiation between China and SACU was initiated in June, 2004. Currently, the two parties are trying to push the negotiation forward to material stages.

6.3.2.6. China-Costa Rica

The FTA negotiation between China and Costa Rica started in November, 2008. During the third round China-Costa Rica FTA negotiation in June 2009, the two parties deeply exchanged views on the second price offer about cargo trade and service trade, market entry permission, primary origin of production, customs procedures, trade remedy, dispute solving and intellectual property, etc.

A lot of agreements have been reached.

6.3.3. International trade agreements under research

6.3.3.1. China-India

China and India are the two countries with the largest population, so the two parties can both benefit from the large market with a total population of 2.4 billion if the two countries establish FTA. India is China's 10th largest trade partner and India ranks No.1 among China's major trade partners in terms of trade acceleration.

In April 2005, China and India announced to initiate the shared feasibility studies on RTA (regional trade arrangement). Five working-team meetings were subsequently conducted. Under mutual efforts, the shared research report was worked out as scheduled. The report notes that China and India should establish FTA so as to reduce and eliminate trade barriers, promote trade liberalization, better investment environment, strengthen economic cooperation, realize mutual benefits and promote the integration of Asian economy.

6.3.3.2. China-Korea

The two countries initiated the government-industry-university shared feasibility research under China-Korea FTA in 2007. So far, five meetings have been conducted.

6.4. International tax treaty issues

6.4.1. Background knowledge

6.4.1.1 The main reason for concluding international tax treaty

One of primary reasons of tax treaties is to remove impediments to international trade and investment by abating the risk of double taxation in cross-border activities. Double taxation arises when two jurisdictions formulate their rights to tax based on different premises. One country ties up the taxation of a cross-border operation to the residence or the nationality of a taxpayer (i.e. unlimited tax liability); the other country ties up the taxation of the same operation to the source or origin of income (i.e. limited tax liability).

6.4.1.2 The approaches applied in tax treaty to avoid double taxation

According to internationally accepted conventions, in order to avoid double taxation, the country of residence has to waive its taxing right either by exemption method or by credit method.

The credit method realizes tax neutrality from the perspective of the capital exporting country (figure 20). That means all taxpayers must pay taxes at the level of their home country (country of residence) with the result that all domestic taxpayers are treated equally and independently of the source of their income (from either domestic or abroad). To achieve this neutrality result, as a general rule, foreign taxes must be credited in the home country without

limitation.

In contrast with credit approach, the exemption method realizes tax neutrality from the perspective of the capital importing country (figure 21). That implies investors abroad are in competition with one another (domestic and foreign) and should be tax uniformly.

In a word, the main distinction of these two approaches lies in, in accordance with credit method; the foreign tax levied in the source country is credited against the domestic tax levied on the worldwide income; whereas, in case of the exemption method, the country of residence exempts the foreign source income from tax.

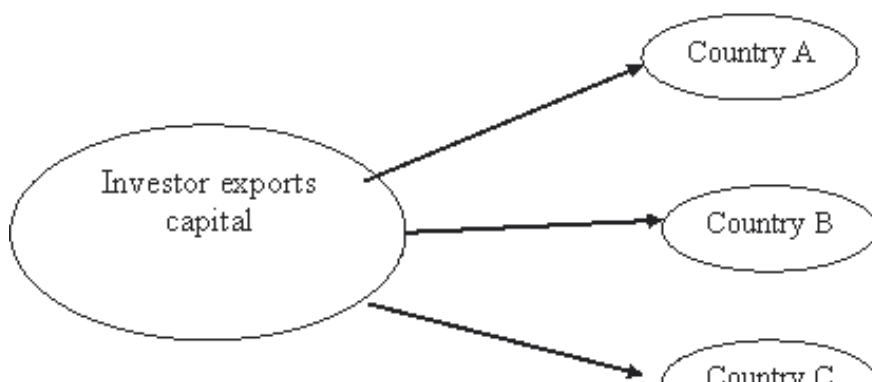


Figure20: Capital export neutrality

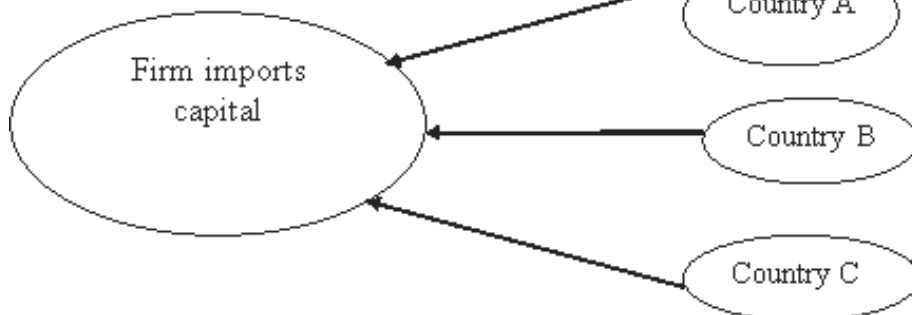


Figure21: Capital import neutrality

6.4.2. Tax treaty issue in China

6.4.2.1 The development of China's tax treaty

China is currently carrying out capital export neutrality and thus the credit method for avoiding double taxation. That means, a tax credit is granted for foreign tax paid on foreign income. The amount of credit is limited to the amount of Chinese tax otherwise payable on the foreign income. A country-by-

country limitation applies, in that the credit for foreign tax paid on income from all sources in one country is limited to the amount of Chinese tax that would have been payable on the income from the same country.

China has now established an international network of tax treaty, signing 90 agreements, including 38 with Europe, 34 with Asia and Oceania, 9 with America and 9 with Africa¹¹. These treaties involved the provisions on business profits, income on immovable property, shipping and air transport, associated enterprises, capital gains, dividends, interest, royalties and fees for technical services at the corporation level and on some kind of personal incomes at the level of resident individuals.

China's tax treaty develops synchronically with its reform and open-up process: Its first phase started in the 1980 and 1990, with its major tax treaties signed with developed countries, Japan being the first to have signed tax treaty with China in 1984. The second phase started in middle of the 1990, with negotiations on tax treaty carried out with newly developing countries. The third phase started after 2000, with more negotiations carried out with developing countries and those invested by China.

6.4.2.2. *Withholding tax rates in the tax treaties*

One of the most important contents in the tax treaties is the withholding tax rates that are applicable to dividends, interest and royalty payments by Chinese companies to non-residents. Table 16 contains relevant withholding tax rates currently in force for several main developed countries and other "BRIC" countries.

As showed in table 16, for most countries, there are almost no differences among the withholding tax rates on dividends, interest and royalty payments. For Brazil, however, the rates of 15% are comparatively higher. In contrast, the withholding tax rates applied to interest for financial institutions and dividends for qualifying companies by Chinese enterprises to corporations in Singapore are more favorable.

¹¹ Please see: <http://www.chinatax.gov.cn/>.

Table 16: The withholding tax rates applied to several main developed countries and other “BRIC” countries.

Country	Dividends (%)		Interest ^{<1>} (%)	Royalties (%)
	Individuals, companies	Qualifying companies		
France	10	10	10	10
Germany	10	10	10	10
Japan	10	10	10	10
Singapore	10	5	7 ^{<2>} /10	10
United Kingdom	10	10	10	10
United States	10	10	10	10
Brazil	15	15	15	15/25 ^{<3>}
India	10	10	10	10
Russia	10	10	10	10

<1> Many of the treaties provide for an exemption for certain types of interest, e.g. interest paid to public bodies and institutions, banks or financial institutions, or in relation to sales on credit or approved loans. Such exemptions are not considered in this column.

<2> The lower rate applies to payments to a bank or a other financial institution.

<3> The higher rate applies to royalties arising from the use or the right to use trademarks.

Source: Asia-Pacific-Taxation and Investment Database <http://www.ibfd.org>)

6.5. Export tax rebate system

Since its reform and open-up, China's export has been surging with its trade volume rising from 18.12 billion dollars in 1980 to 2561.63 billion dollars in 2008. Although internationally sales tax on export commodities is completely exempted, China's export tax rebate policy acts not only as an instrument in promoting export and adjust structure of export products, but also as an important means of macro-economy to reduce trade frictions, achieve a balance between international revenue and expenditure and safeguard economic growth and full employment.

6.5.1. Development of export tax rebate system

China's reform of export tax rebate system has been developing over three major periods:

The first period is from 1985 to 1993. 1985 saw the start of export tax

rebate system. In 1988 a new rule was made requiring tax rebate should be connected with foreign exchange earnings on enterprises' part and their turnover to the central government.

From 1994 to 2004 is the second period. In 1994, tax-sharing reform established a new VAT system, on the basis of which a new export tax rebate system took shape, levying zero tax on export commodities.

Since the January 1st, 2004, the beginning of the third period, major adjustments have been made to the system, according to the Decision of the State Council on Reform of the Existing Export Tax Refund Mechanism, primarily to make payment to tax rebate in mechanism.

6.5.2. The reform content of export tax rebate system 2004

The export tax rebate system was reformed in many aspects in 2004. First of all, structural adjustment has been made to reduce export tax rebate rate of different export commodities.

Second, the central government increased its fiscal allocation for export tax rebate. Since 2003, the increment revenue of VAT on import commodities and consumption tax has been first afforded for export tax rebate to ensure its payment to export enterprises completely and in time.

Third, a sharing payment for export tax rebate system between the central government local governments was established stipulating. Starting from 2004, the total of export tax rebate in 2003 is to be the payment base, and the excess is to be borne by the central and local governments by 75:25.

Last, accumulated unpaid tax rebate is to be borne by the central government, which is to pay the export tax rebate accumulated by the end of 2003 and make up the local revenue deficiency affected by VAT sharing system. Starting from 2004, central finance offers total discount to the tax refundable to exporting enterprises.

6.5.3. Recent adjustments

The years after 2004 saw some minor adjustments to the export tax rebate system:

Firstly, in 2005, the State Council issued the Notice of the State Council Concerning Perfecting Export Tax Refund Bearing Mechanism by Central government and Local governments, stipulating the excess of export tax rebate should be borne by the central and local governments by 92.5:7.5 from the beginning of 2005.

Secondly, in 2007, export tax rebate rate of some commodities was adjusted, the final five rates being 5%, 9%, 10%, 13% and 17%.

Third, since the August 1st, 2008, a series of policies to raise the rebate rate have been frequently presented in order to address international economic

crisis and prevent export from dropping sharply and consequently affecting the steady development of Chinese economy. However, whether this is effective remains to be seen.

7. Conclusions

Despite of less importance of tax system arrangement in Chinese current constitution, there are much room for China to make progress on construction on taxation law.

The Chinese taxation system has been reforming from the 1980s according to the demands for economic and social development. The current tax system in China is adapted to the requirements of establishing and improving socialist market economic system, but has its own characteristics. The most important feature is that its base of taxation is consumption rather than income and property which contribute greatly to raising fiscal revenues.

Based on the Chinese experience, the size and composition of tax revenue have important effects on the volume of production and consumption within the various economic sectors. In this manner, taxation is inevitably correlated to GDP and international trade relations. In another aspect, expansion of huge GDP and sound international trade relations are of significance in the increase of tax revenues. Among many important influence factors to attract FDI, preferential tax policy may contributes to the investment flow to China but not a fundamental incentive for some foreign investments.

Although facing with the great challenge of current financial crisis in the world, China will continue to extend its opening to the world and reform its political and economic systems. Certainly, Chinese tax system needs to be further reformed in order to satisfy the demands of future political, economic and social developments.

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