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CHINA TAX LAW: THE "TAX PROCESS"*

GEORGE W. CREGG, SR.**

Between 1979, the year in which Sino-United States diplomatic relations were established, and 1989, the total volume of bilateral trade between the United States and China has risen to over U.S.\$50 billion. In 1986, it was U.S.\$7.3 billion; in 1987 over U.S.\$10.4 billion. In 1987, the United States exported U.S.\$3.5 billion in goods to China, and imported U.S.\$6.9 billion in merchandise from China. In 1986, the United States was China's third largest trading partner.¹ China is also a major trading partner of the United States; twelfth in exports to the United States and seventeenth in imports from the United States.² China plans to increase its foreign trade at an average rate of 7% to over U.S.\$80 billion by the year 1990. According to statistics developed by the Ministry of Foreign Economics and Trade ("MOFERT"), from January to June 1987, foreign investment by the United States in China amounted to U.S.\$137,710,000, consisting of U.S.\$44,280,000 in loans and U.S.\$93,430,000 in direct investment.³ In 1989, the tenth year of its new relationship with the United States and the fourth year of its seventh "five-year plan," China is moving towards strengthening its economic exchanges with the United States.

"If I am going to do business in the People's Republic of China, am I going to be required to pay Chinese taxes?" is a somewhat silly

* This article was originally delivered as a speech at the Ernst C. Stiefel Symposium on China in April 1989, prior to the incidents that occurred in Tiananmen Square in June 1989. Thus, the views expressed in this article do not reflect any changes that may have occurred in China as a result of the June events.

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1. See MINISTRY OF FOREIGN ECONOMIC RELATIONS AND TRADE OF THE PEOPLE'S REPUBLIC OF CHINA, *INTERNATIONAL BUSINESS MONTHLY* 16 (Oct. 1987) [hereinafter *INTERNATIONAL BUSINESS MONTHLY*].

2. See U.S. DEP'T OF COMMERCE, 109 *BUSINESS AMERICA*, No. 9, at 6 (Apr. 25, 1988).

3. See *INTERNATIONAL BUSINESS MONTHLY*, *supra* note 1, at 36, 62 (Sept. 1987).

question often asked by executives of small and medium-sized businesses. An affirmative answer elicits another question: "Where can I get a list of the taxes that must be paid?" For such a lay person, several firms of lawyers and accountants have prepared and published two and three-page summaries of the individual and corporate taxes that must be paid to China. The similarity of the various kinds of taxes levied by China to the kinds collected by the United States is obvious. The most important question that should be asked, however, may not be asked by an inquiring businessman: "What process is used to collect the Chinese taxes?" The list of "taxes" may be quickly assembled but the "tax process" by which the tax laws are created and the administration of such laws needs examination. The "process" goes beyond the forms, the rates, and the exemptions. The routine collections are tolerable or few businesses would be set up in China and business is booming. While the success of tax collectors is as certain as death, the road to that happy ending for the Chinese collector is what we need to examine.

So-called legal realists have defined law as the "process of determining causes and controversies according to the authoritative guides for the purpose of upholding the legal order."⁴ Judge Cardozo called this concept "the judicial process."⁵ When we discuss any tax law we are usually discussing a process: (1) of enactment and interpretation of a statute, rule or regulation; and (2) the application thereof by the executive branch of a government. In the field of tax law, lawyers are functioning more as civil-law lawyers than as common-law lawyers. Understanding the tax law process is a beginning for knowing and understanding the tax law and its application in China.

American taxpayers are confronted with complexity, slowness, uncertainty, varieties of interpretations, claimed simplification, and confusing rules in the American tax law system. American citizens and corporations doing business in the PRC face similar perplexing difficulties as American taxpayers face every day, plus they are confronted with a Chinese "hell-bent-for-election" effort to implement new tax laws in a legal structure where policy sometimes functions as law, and business is exploding with little time to fight about the tax laws or the interpretation thereof. Fortunately for Americans, the present policy of China favors the expansion of business with United States companies. An expanding economy, however, requires extra financial support in the form of taxes or similar forms of revenue, and increases are as inevitable in China as they are in the United States.

4. See R. POUND, *JUSTICE ACCORDING TO LAW* (1951).

5. See generally B. CARDOZO, *THE NATURE OF THE JUDICIAL PROCESS* (1921).

"Fuzzy Logic" is a computer term created to permit the use of computers with imprecise terms. Fuzzy Logic permits computers to use terms like "slightly," "warm," and "expensive," instead of the precise computer terms usually used. Fuzzy Logic is designed to make decisions that would probably be made in a similar way by human minds in an imprecise manner.⁶ During the current vast expansion of business with the Western world, Chinese courts must sometimes approach decisions with a background of a relatively clear policy, but with the absence of a specific law or a general tax law which does not seem to specifically cover a given set of facts. The decision or end result reached by the Chinese courts may more readily be compared to a negotiated settlement in an American arbitration proceeding than a decision by an American court of law. A Chinese tax ruling in some situations may be compared to a settlement of a tax audit by a United States Internal Revenue Service agent.

Certainty is the first law of any business in a capitalist nation such as the United States. Unless a bank check, bill of sale, bill of lading, or other business document will be handled in a uniform way, business people will be delayed and discouraged. Some individuals or corporations may decide not to do business in an area where there is a lack of certainty. That is one reason why the United States, through the Export-Import Bank, will make insurance available on certain types of international transactions.

The wedding of Fuzzy Logic and certainty by the most adroit tax lawyer is sometimes very difficult in either the United States or the PRC, yet blame for delay or uncertainty may quickly be placed on the tax lawyer or lawyers involved.

Justice Roscoe Pound once wrote, "The science of law is a science of social engineering having to do with that part of a whole field which may be achieved by the ordering of human relations through the action of politically organized society."⁷ Pound has been heard to define justice in sociological terms as "the satisfaction of the maximum number of human wants with the least possible amount of friction and waste."⁸ He has reasoned that even though a science, law may appear to be imprecise at times because of the continuous strain put upon the courts in order to apply law in situations that allow for only a zero "margin of error."⁹ When an engineer designs a building or bridge, he can allow for errors in judgment by over-designing a structure or

6. Pollack, *Fuzzy Computer Theory: How to Mimic the Mind?*, N.Y. Times, Apr. 2, 1989, at A1, col. 4.

7. R. POUND, *supra* note 4, at 30.

8. *Id.*

9. *Id.*

strength, with moderating cost as the only straining limit. A lawyer is usually faced in any litigation, real or threatened, with an unforgiving adversary and no allowable margin of error. Tax collectors have historically been unforgiving adversaries and tax controversies have ended in negotiated settlements.

To understand Chinese tax law, we must know that the innovative ancient China that invented gun powder and sent Marco Polo back to Italy with pasta, is today developing new tax laws and regulations during a period of enormous growth of all areas of business in a country with the largest population in the world. China is considered a developing nation by the United Nations Industrial Development Organization, and China is truly moving the fastest of all the developing countries of the world. In a nation which has such a deep regard for the worker that nothing is thought to have value unless value is added by human labor, an American, imbued with profit and property rights philosophies, finds difficulty understanding some aspects of the Chinese taxing system.

Because all major legislation in China emanates from the central government, and only minor legislation is permitted on a local basis, the current national policy of the PRC must be carefully examined with regard to any questions of law, especially laws, resolutions and regulations regarding the taxes which provide the financial support for the government. Since the National People's Congress (the "NPC") and its Standing Committee can change the Constitution or a basic law, existing policy has a stronger meaning in China, and may have the force of law as we know it, especially if such policy is enunciated by or otherwise related to the NPC.¹⁰ Whenever a set of facts are not clearly covered by the law, policy will be applied with the apparent effect of law.

When the Individual Income Tax Law of the People's Republic of China, the Income Tax Law of the People's Republic of China Concerning Foreign Enterprises and the Income Tax Law of the People's Republic of China Concerning Joint Ventures, are compared with Chinese and Foreign Investment, as adopted in 1980 and 1981, concise and simplified general provisions are identifiable, which are usually not as easy to administer as statutes of the voluminous size of the United States Internal Revenue Code of 1986.

In examining the taxes levied by the PRC or of a local government of China, the philosophy behind Chinese law must be kept in mind. Sometimes the application of a law to a particular set of facts may

10. See T. HSIA & C. JOHNSON, *LAW MAKING IN THE PEOPLE'S REPUBLIC OF CHINA: TERMS, PROCEDURE, HIERARCHY, AND INTERPRETATION* (1986).

result in a favorable decision anticipated by a Western lawyer or businessman. Such decisions, however, may be viewed by a Chinese jurist in an entirely different light than the legal philosophy applied by a Western idealist. An unfavorable decision may come forth unexpectedly because we may not understand Chinese legal philosophy or its application to current situations.¹¹ The Chinese are not in the habit of keeping strict legal documentation which is so common to the American legal system. Chinese government officials or business executives may urge American participation in a Chinese joint venture, however, the Americans approached may not be able to attach a firm grip on the laws that will apply to the particular venture proposed.¹²

For the most part, Chinese taxes and their application appear to be fair under the circumstances. All foreign businesses (other than joint ventures), whether in the name of the corporation or otherwise, are taxed on profits earned from business activities carried on in China. American companies without an actual establishment in China may be subject to a withholding tax on China source income. Individuals will be taxed for all income derived from within China's borders, and some foreigners on an overseas payroll may be taxed if they are physically present in China for more than ninety days in a year. While joint ventures are encouraged by tax incentives, joint ventures must follow the rules and methods of accounting, and income taxes are levied on the joint ventures worldwide income.

The vast future of modern China can only be assessed in cosmic terms. China may need some raw materials, some technology transfer, and some counseling in business management. With very little help and assistance from China's friends both in America and the rest of the world, China is clearly destined to be the kind of world leader that her enormous population implies. With the rise to new leadership, an expanded Chinese tax law and a more sophisticated tax process are inevitable.

11. See generally H. KIM, *FUNDAMENTAL LEGAL CONCEPTS OF CHINA AND THE WEST-A COMPARATIVE STUDY* (1981).

12. See Huang, *Joint Ventures, Prospects and Problems*, in *DOING BUSINESS WITH CHINA* 48 (1980).

