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Fiscal Federalism in Chinese Taxation

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The recent policy literature on fiscal federalism in China has concentrated on the large "vertical fiscal gap" resulting in inadequate local provision of public goods and services. Thus there is an evident interest in giving local governments more taxing powers. After a brief historical survey, the article discusses a 1993 State Council directive that centralized taxing power. This has led local governments to make use of their control over tax administration to alter effective tax rates, and to the practice of "refund after collection", whereby local governments disguise tax cuts as expenditures, following a logic opposite to tax expenditures. This study concludes, firstly, that the allocation of taxing power is still done outside the framework of the law, and secondly, that the government has not been able to settle on a stable allocation. Skirmishes over the control of local tax reductions and preferences remain a continuous affair.

Contents

1. Introduction

Among public finance scholars, it is widely agreed that the idea of "fiscal federalism" – the allocation of taxing powers and expenditure responsibilities among different levels of government in a single polity – applies to states that are politically unitary just as it does to politically federalist states. This is because even in a unified state with hierarchical levels of government, the higher levels of government may devolve tax and/or spending decisions to lower ones. China, which is a unitary state,[2] illustrates this point perfectly through the distribution of spending powers among its central (i.e. national) and sub-national levels of government. By what is considered the "most common measure of the extent to which a system is centralized [,] the centralization ratio, [i.e.] the proportion of total government

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1. The author wishes to express his gratitude to Professor Jie Cheng at Tsinghua University Law School for discussions of the Chinese Constitution and other aspects of the subject of this chapter.

2. The Constitution of the People's Republic of China, as last amended in 2004 (the "Constitution"), art. 3.

expenditures made by the central government",[3] China is more decentralized – and therefore, one might say, more "federalist"– than some federalist polities. In 2008, this ratio in China was a low 21.42%,[4] compared to 43% in Canada (in 2002) and 51% in the United States (in 1999).[5] Therefore, one should not be surprised to learn that fiscal federalism, in its substance, has been a perennial topic in discussions of the Chinese economy and Chinese politics both within China and abroad, even though such discussions are often conducted under the heading of "central-local fiscal relations," while the term "fiscal federalism" is often eschewed for political reasons.[6]

Western theories of multi-governmental public finance reflecting the founding works of Tiebout, Oates, etc. have been gradually introduced to China, not the least because such theories underlie some of the policy analyses and recommendations sponsored by the World Bank and other international organization engaged in dialogue with the Chinese government. As some scholars have pointed out,[7] many such theories adopt assumptions about the political systems (e.g. multi-level democracies with party competition) in which tax and expenditure assignments are made, that may not hold in non-Western, including Chinese, contexts. In what sometimes purports to be a "second-generation" theory of fiscal federalism, social scientists have directly based their theories and evidence on phenomena associated with transitional economies, claiming, for example, that decentralization, by creating intra-governmental competition, can promote economic growth.[8] Both the conceptual underpinnings of such theories and the evidence adduced to support them have been subject to vigorous debates.[9]

The more recent policy literature on fiscal federalism in China has focused on the current large "vertical fiscal gap", which refers to the phenomenon where the central government receives much more tax revenue than it directly spends, and where local governments' shares of tax revenue fall short of their shares of expenditures. Because of this gap, local governments rely heavily on non-tax sources of local revenue and transfer payments from the cen-

3. Rosen, Public finance, p. 506.
4. Author's computation is based on the Report of the Ministry of Finance (MoF) on the Implementation of the 2008 Central and Local Budgetary Plans (the "2008 Budget", Mar. 5, 2009), available in Chinese at http://news.xinhuanet.com/newscenter/2009-03/15/content_11014326.htm.
5. Rosen, *Public finance*, supra note 1, pp 506-7. This ratio was 81% in France (a unitary state) in 2002. Id.
6. For anthologies of discussions in Chinese, see, e.g. Liu Kegu and Jia Kang, *Thirty years of Chinese fiscal and tax reform: personal accounts and retrospections* (Economic Science Press, 2009)("*Thirty years*"), Chapter 2; Liu Jibin (ed.), *Research on reform of the national public finance system* (Democracy and Law Press, 2008). For anthologies in English, see, e.g. Lou Jiwei and Wang Shuilin, *Public finance in China* (World Bank 2008); Vivienne Shue and Christine Wong (eds), *Paying for progress in China: public finance, human welfare and changing patterns of inequality* (Routledge, 2007); The World Bank,*Report: China: national development and subnational finance, a review of provincial expenditures* (2002).
7. See, e.g. Roy W. Bahl, "Intergovernmental Fiscal Relations and Local Public Finance: What Is Next on the Reform Agenda?" in Joyce Yanyun Man and Yu-Hung Hong (eds.), *China's local public finance in transition* (Lincoln Institute 2010); Richard Bird, "Taxation and Decentralization," Economic Premise, No. 38, November 2010 (World Bank).
8. See, e.g. Wallace E. Oates, Toward A Second-Generation Theory of Fiscal Federalism, International Tax and Public Finance, 12, 349-373, 2005; Hehui Jin, Yingyi Qian and Barry R. Weingast, "Regional Decentralization and Fiscal Incentives: Federalism, Chinese Style," Journal of Public Economics, September 2005, 89(9-10), pp. 1719-1742.
9. See, e.g. See, e.g. Jonathan Rodden and Susan Rose-Ackerman, "Does Federalism Preserve Markets?" 83 Va. L. Rev. 1521; Olivier Blanchard and Andrei Shleifer, "Federalism With and Without Political Centralization: China Versus Russia," IMF Staff Papers, 48, Special Issue, pp. 171-9 (2001); Hongbin Cai and Daniel Treisman "State corroding federalism," Journal of Public Economics, 88, pp. 819-843 (2004); Hongbin Cai and Daniel Treisman, "Did Government Decentralization Cause China's Economic Miracle," World Politics, 58:505-535, 2006.

ter for their operations.[10] For example, in 2008, while the sub-national levels of government were responsible for 78.58% of total government expenditures, they were directly allocated only 42.89% of total tax revenue.[11] This is perceived to be partly responsible for the under-provision of public goods and services such as education, medical care, poverty assistance, etc. by local governments in much of the country. There is thus a persistent interest in the questions of whether, and how, taxing power may be decentralized to a greater extent than it is today. Moreover, the fairly quick pace of Chinese tax reform – including the upcoming integration of the VAT and the Business Tax, the possible introduction of a western-style property tax and miscellaneous environmental taxes – continues to raise the inevitable question of how the distribution of taxing powers will be shifted when China's tax structure is reconfigured.

As this chapter will show, the legal debate about the decentralization of taxing power in China has mainly centered around a directive issued by the State Council (China's cabinet) at the end of 1993, which, at the same time as launching the well-known and widely-discussed tax reform of 1994,[12] announced that legislative power regarding taxation would be reserved exclusively for the central government (the "centralization doctrine"). This directive has no constitutional basis, and its subsequent statutory incarnations are all either incomplete or ambiguous. Moreover, in the adoption of tax regulations for many types of taxes, there have been numerous deviations from this principle of centralization, and the bearing of such deviations on the centralization doctrine is unclear. Just as importantly, the central government has not been able to effectively enforce the centralization doctrine against local governments, especially in terms of curtailing local tax preferences. Throughout the 17 years since the adoption of the State Council centralization directive, local governments have found and continue to find ways to offer tax preferences unauthorized by the central government, through either manipulations of or simple disregard for written rules. Finally, the policy justifications for the centralization doctrine have not been sufficiently articulated. All these cast doubt on whether the centralization of tax legislative power is indeed a fundamental normative principle for Chinese law and policy, and whether it is not instead, as a more skeptical view would hold, a mere slogan wielded by the central government as a non-neutral party in political contests. This means that fiscal federalism in taxation in China is still very much in an unsettled state, and does not represent a coherent model.

The report will be organized as follows. Section 2 briefly summarizes the structure of government in China and the history of the devolution and centralization of taxing power between 1949 (when the People's Republic of China was founded) and 1994. Section 3 then lays out the current legal framework, erected by 1994, that purports to vest tax legislative power exclusively with the central government, and highlights the framework's infirmities and ambiguities. Section 4 then sets out the evolution (since 1994) and the current state of the "tax sharing" scheme (fenshui zhi) and the associated bifurcated system of tax

10. See, e.g. Athar Hussain and Nicholas Stern, "Public Finances, the Role of the State, and Economic Transformation, 1978-2020," and Jorge Martinez-Vazquez, Baoyun Qiao, Shuilin Wang, and Heng-Fu Zou, "Expenditure Assignments in China: Challenges and Policy Options," Chapters 2 and 5 in Lou and Wang, *Public finance in China*.

11. Sub-national governments received 75.99% of all non-tax revenue, 46.72% of total fiscal (tax and non-tax) revenue, and local state-owned enterprises (SOEs) accounted for 30.24% of total SOE profits. All computations are based on the 2008 Budget.

12. The State Council Directive, as well as several important ancillary documents discussed in 3. and 4. below, were all issued in 1993, but their prescriptions, particularly regarding the tax sharing system, took effect in 1994. This chapter therefore follows a long-established convention and speaks of the "1994 tax reform".

administration. These systems, though not codified in forms that possess clear legal effect, fundamentally shape tax legislation. After having thus delineated the legal and institutional architecture of a purportedly centralized tax system, Section 5 then details how local governments have pursued unauthorized tax policies, explicit or disguised. It seems that local governments are mostly driven to offer tax reductions through such means, either to compete for businesses generally or to promote or help particular enterprises, although more recently some local governments have also lobbied for the right to devise tax increases. The central government has periodically responded to such local initiatives in a negative fashion, issuing prohibitions against local tax reduction, but arguably doing so ineffectively. Finally, the Conclusion stakes out the claim that while the centralization doctrine imperfectly characterizes the current distribution of taxing power in China, a coherent vision for (limited) decentralization has yet to be developed.

2. Structure of Government and Historical Background

2.1. Levels of government

There are currently five levels of government in China:[13] the national or central government, provincial-level jurisdictions (sheng),[14] prefectures/municipalities (diqu/shi),[15] counties (xian), and townships (xiang or zhen).[16] In each of the sub-national jurisdictions – it is common in China to refer to all of them (even provincial-level ones) as "local"–there is a people's congress and a people's government.[17] A local people's congress, the members of which are supposedly elected, is the ultimate seat of state power in that local jurisdiction. It in turn elects the top officials in the local people's government, exercises the appointment and removal of power over top local judicial and procuratorial officers, as well as elects delegates to the people's congress at the next-higher level. It is also supposed to exercise other powers to ensure the implementation of higher law and national economic and other policy agendas, monitor the performance of the local people's government, and generally advance various local social interests.[18] Importantly, each local people's congress – down to the over 40,000 townships – may adopt budgets for their respective jurisdiction.[19] The people's governments, on the other hand, represent the executive branch. At the provincial level, for example, the

13. This administrative division is reflected, for example, in the Budget Law (National People's Congress (NPC), Mar. 22, 1994, effective Jan. 1, 1995), art 2, although the Constitution (art. 30) provides for only four levels of administration, which do not include prefectures. In recent years, there has been a drive to reduce the number of layers of governments. For public finance purposes, this typically involves (1) having the province and the county deal directly with each other in fiscal management, skipping the prefecture, and (2) reducing the expenditure responsibilities of townships. After such administrative simplification, the remaining three layers of government (center-province-county) would bear greater resemblance to administrative divisions in other countries.
14. Excluding Hong Kong, Macau and Taiwan, there are 31 such jurisdictions at present: 4 centrally administered cities (Beijing, Shanghai, Tianjin and Chongqing), 22 provinces and 5 ethnic autonomous regions (Tibet, Xinjiang, Guangxi, Ningxia and Inner Mongolia).
15. The contemporary prefecture is a product of administrative reform in the 1980s. The growth of the Chinese economy has meant that even counties are becoming major economic and administrative units, and therefore it is expected that prefectures will be phased out.
16. As of 2004 (the last time for which a public survey is available), there were 333 prefectures. 2,862 counties and 41,636 townships in China.
17. See, generally, Organic Law of the Local People's Congresses and Local People's Governments (Standing Committee of the National People's Congress (NPCSC), Jul. 4, 1979, amended for the 4th time Oct. 24, 2007). ("Organic Law of Local Governments").
18. Id. arts. 4, 8-10.
19. The Budget Law, art. 2. Provincial-level governments may waive the requirement of adopting budgets for township-level governments that are not prepared to do so. Id.

people's government is essentially the office of the provincial governor and vice-governors, which supervises various departments and bureaus. The same arrangement of a head executive office and specific government agencies (e.g. those in charge of finance and of taxation) is replicated in lower-level jurisdictions.

While it is tempting to think of the pairing of local people's congresses and people's governments as reflecting the familiar distinction between the legislative and executive branches of government, most local people's congresses do not possess legislative power. The Constitution only endows people's congresses of provincial-level jurisdictions with the power to enact local statutes (*difangxing fagui*).[20] The Organic Law of Local Governments more expansively provides that people's congresses of provincial capitals and certain "relatively large cities" determined by the State Council may also adopt local statutes, subject to the approval of such statutes by the legislature of the provincial-level jurisdiction in which they sit.[21] The Law on Legislation further adds that cities in which special economic zones are located can also adopt local statutes, subject to approval at the provincial level.[22] Still, this implies a mere 49 local congresses below the provincial level that can make local statutes,[23] a far smaller number even than the number of prefectures, let alone counties and townships.

Under the current Chinese legal system, codified most importantly in the Law on Legislation, only two forms of generally applicable rules adopted by government entities at sub-national levels have a formal, independent legal effect.[24] These are local statutes and local government regulations: the latter may only be adopted by people's governments at those levels of jurisdictions where the corresponding people's congresses have the power to adopt local statutes.[25] This means that there are far fewer local law-making bodies than there are budgetary units, and most local congresses exercise their budgetary and other powers without the binding force of law. This has important implications for the tax dimension of fiscal federalism: if lawmaking power in general is decentralized only to this limited extent, the decentralization of tax lawmaking power must of necessity also be limited.

20. The Constitution, art. 100.
21. Organic Law of Local Governments. Art 7. No local statutes may contravene the Constitution, national statutes or State Council regulations, and they must be filed with the NPCSC and the State Council for record. Id.
22. Law on Legislation (NPC, Mar. 15, 2000, effective Jul. 1, 2000), art. 68.
23. These are located in 27 provincial capitals, 4 cities that host special economic zones, and 18 "relatively large cities" specially designated by the State Council.
24. This is reflected in many statutes adopted after the Law on Legislation (2000) and is most importantly enforced through the Administrative Litigation Law (NPC, April 4, 1989, effective Oct. 1, 1990), which, under the interpretation of the Supreme People's Court, only accepts rules recognized as law by the Law on Legislation as independent sources of law when adjudicating disputes with government entities. See, generally, Wei Cui, "The Rule of Law in Chinese Tax Administration", Judith Freedman, Chris Evans, Rick Krever (Eds.), *The delicate balance: taxation, discretions and the rule of law* (IBFD 2011), pp. 335-366.
25. Law on Legislation, art. 73. At the national level, sources of law include the Constitution, laws (*falü*) adopted by the NPC or NPCSC, "administrative regulations" (*xingzheng fagui*) issued by the State Council, and ministerial regulations (*bumen guizhang*) issued by the central ministries.

2.2. Brief pre-1994 history of devolution and recentralization

Ever since the founding of the People's Republic, the Chinese government has struggled with the question of how to allocate taxing power within a unitary state. Under the "Key Rules for Implementing National Taxation Policies",[26] an executive decree issued in 1950 (before the nation's first Constitution was adopted), the central government attempted to create national order in taxation by centralizing the power of making tax law, imposing or ceasing to impose any given tax, and adjusting the tax base and tax rates.[27] Nonetheless, local, particularly provincial, governments were given some authority for legislating local taxes, subject to the approval of the central government.[28] In 1958, on the eve of the Great Leap Forward – Mao Zedong's attempt to accelerate economic modernization through mass mobilization – the Standing Committee of the National People's Congress (NPCSC) approved the State Council's "Provisions for Improving the Tax Administration System",[29] which further decentralized tax legislative powers. The "Provisions" laid out the following principles for "improving the system of national tax administration"[30]: "any tax that could be administered by [provincial-level jurisdictions] should be administrated by them; for those taxes that remain administered by the central government, [provincial-level] governments should be given some scope for flexible adjustments; and [such governments] should be allowed to make tax regulations and introduce local taxes."[31] Some attempts at recentralization were made in the early 1960s, but the Cultural Revolution only deepened the extent of devolution.[32]

One year after the end of the Cultural Revolution had been declared, the State Council once again attempted to centralize the power to make tax law and policy. A set of rules drafted by the Ministry of Finance (MOF) provided that "any change of national tax policies, the promulgation and implementation of tax laws, the initiation or termination of the collection of any tax, and changes in taxable items and tax rates shall all be ruled uniformly by the State Council."[33] For the main part, provincial governments could only make specific measures for tax collection to implement the central unified tax laws, although they could still decide, with the approval of the MOF, to either begin or terminate the collection of a certain tax, and

26. See, Liu Zuo, "The First Guiding Document in the History of Taxation of New China", China Taxation News, Jan. 16, 2009, p. 4.
27. Fu Hongwei, "The Understanding and Evaluation of the Framework Rules for Tax Legislative Power," Taxation Research 2004(12), pp. 33-5 (at p. 33).
28. See, Liu Zuo, "Local Taxes in the Early History of the Republic," available in Chinese at http://www.dfczyj.com/Article/ShowArticle.asp?ArticleID=455; Huo Jun, "Sixty Years of Evolution of the System of Tax Administration in New China," Research on Contemporary Chinese History, 2010, No. 3, pp. 52-9.
29. Adopted by the 75th Plenary Meeting of the State Council on Apr. 11, 1958, approved by the 97th Meeting of the NPCSC on Jun. 5, 1958, and publicly released as a State Council Decree on Jun. 5, 1958.
30. "Under the historical conditions of that time, law was merely a tool of administration, and not a standard that limits government behavior, and so the institutional perspective of allocating and analyzing taxing power in terms of law did not exist. The 'system of tax administration' was a general term covering many specific systems such as tax legislation, enforcement and adjudication." Fu Hongwei, "The Understanding and Evaluation of the Framework Rules for Tax Legislative Power, at p. 33.
31. Id. "In other words, the administrative power for taxes that have their revenue allocated to local governments was granted entirely to provincial-level governments; the latter were also given some power for adjustments, reductions and exemptions for centrally-administered taxes.".
32. Huo Jun, "Sixty Years of Evolution of the System of Tax Administration in New China".
33. Measures on the System of Tax Administration, approved and released by the State Council, Nov. 13, 1977, art. 1. This provision has been criticized for bypassing the NPC and thus as "representative of an age of rampant nihilism about the rule of law". Fu Hongwei, "The Understanding and Evaluation of the Framework Rules for Tax Legislative Power".

to implement tax exemptions and reductions.[34] However, throughout the 1980s, the extent of decentralization in taxation became much greater than these provisions suggest. Because the central government itself did not organize tax collection (as it does today through the State Tax Bureau system),[35] and instead relied on local governments to remit its share of tax revenue, tax agencies across the country soon became more like agents of their local government bosses than implementers of national law. Actual tax policy became more varied across localities than it had ever been. Indeed, as long as provincial governments fulfilled their fiscal contracts with the center (which set targets for revenue remittance), the center exercised little additional control. Moreover, the very function of taxation was just gradually being revived as China was leaving socialist economic planning behind, and the new taxes devised by the central government were merely transient, experimental measures that often faltered. As a result, centralized tax legislative power meant very little. It was not until the 1994 tax reform that it was given real substance, and that the legal framework for fiscal federalism in taxation became worthy of serious examination.

3. Framework Rules on Tax Lawmaking

3.1. The Constitution: minimal guidance

The Chinese Constitution, throughout its successive amendments, has merely stated that Chinese citizens have the obligation to pay tax in accordance with law,[36] and contains no other provision regarding taxation.[37] It is difficult to construe the term "law" as used here to refer only to national statutory law, because many other appearances of the term "law" in the Constitution clearly express a wider conception of law.[38] Although the doctrine of "tax legalism" (shuishou fading zhuyi) – the idea that rights and obligations with respect to taxes must be provided by law adopted by the legislative branch, as the basic elements of a tax – has numerous adherents among Chinese scholars,[39] this doctrine is generally not regarded as enshrined in the Constitution.

The Constitution does embody a view of the National People's Congress (NPC) and its Standing Committee (NPCSC) as the supreme sources of law,[40] which applies to all legislative matters, including taxation. Despite this Constitutional framework, the NPC made sweeping and vague delegations of authority to the executive branch and the judiciary either to interpret or to make law during the 1980s, when it was still not fully prepared to function.[41]

34. Id. arts. 2 and 4.
35. Discussed 4.2 infra.
36. The Constitution, art. 56.
37. Art. 117 of the Constitution recognizes "the autonomous rights to manage local fiscal affairs" on the part of ethnic autonomous regions, and provides that fiscal revenue allocated under the national fiscal system to an ethnic autonomous region may be used by that region under its own discretion. This report omits the special tax policies adopted for ethnic autonomous regions, which, for both normal policy and special political reasons, receive large transfers from the central government.
38. See, e.g. art. 18 of the Constitution (foreign businesses operating in China must comply with Chinese law).
39. See, e.g. Zhang Shouwen, "On Tax Legalism", Legal Research (*faxue yanjiu*) 1996(6), pp. 57-65; Liu Jianwen and Shen Liping, "Two Basic Problems in the Law on Legislation and Tax Law," Taxation Research (*shuiwu yanjiu*) 2001(7), pp. 70-5, at 70. According to the understanding of Chinese scholars, "tax legalism" supposedly originated in the western concept of "no taxation without representations", and had legal precedent in the English Petition of Right in 1627 and the American Declaration of Independence in 1776. Id.
40. Arts. 57-8, 62, and 67 of the Constitution.
41. See, e.g., NPCSC, Resolution Regarding Strengthening the Interpretation of Law (Jun. 10, 1981); Decision of the NPCSC to Authorize the State Council to Reform the System of Industrial and Commercial Taxes and Issue Relevant Draft Tax Regulations for Trial Application (issued on Sep. 18, 1984 and repealed on Jun. 27, 2009).

Among these acts of delegation was one that occurred in 1985 and that is still believed to operate today, whereby the NPC gave blank permission to the State Council to make rules or regulations regarding all issues relating to "reform of the economic system and opening to foreign countries."[42] The mandate is understood to encompass all tax policymaking. The constitutionality of this delegation has been extensively discussed by scholars, but because the Chinese Constitution is not currently justiciable and constitutional review by the NPC almost unheard of,[43] the issue remains somewhat theoretical. Indeed, some scholars have argued that the 1985 Delegation affirmed parliamentary supremacy, by making it clear that the State Council merely exercises delegated authority in its lawmaking activities in the economic area, whereas beforehand, it was not clear that the decisions of the State Council were subject to any legal constraint.[44]

Finally, the following negative inference may be drawn from the Constitution. The Constitution recognizes the legislative power of both national and provincial-level legislatures,[45] and contains no provision suggesting that tax legislative power is somehow different and reserved for the central government. In other words, the Constitution itself does not contemplate the centralization of taxing power.[46] Given the supremacy of the national legislature, national statutes may still provide for such centralization, but as we will see in 3.3., existing statutory provisions on this matter are not entirely unequivocal.

3.2. The 1993 State Council Directive

In the tax area, the most important exercise of the 1985 Delegation by the State Council is arguably the latter's orchestration of the 1994 tax reform, which founded the structure of Chinese taxation that still stands today and is sometimes claimed to be the most successful reform effort in the recent history of China's economic transformation. At the center of that reform was a "decision"[47] issued by the State Council at the end of 1993. This decision laid out the basic elements of a new system of fiscal management among the central and provincial governments, including, most importantly, a "tax sharing" system that governs how revenue for different taxes was to be collected and shared amongst central and provincial governments. Two policy objectives of the tax sharing system were clear: the central government wanted to increase its share of total tax revenue in order to reverse a dangerous decline of such a share in prior years; it also wanted to take control of certain broad-based taxes (such as VAT and Enterprise Income Tax (EIT)) so as to use them as national economic policy tools. But arguably going beyond what was necessary to achieve these objectives, the 1993 Decision also announced that the "legislative authority for central, shared, and local

42. Decision of the NPC on Authorizing the State Council to Formulate Interim Provisions or Regulations Concerning Economic Structural Reform and Open Policy (Apr. 10, 1985) (hereinafter the 1985 Delegation).
43. No court may review the constitutionality of a law and such a review must be carried out by the NPC or NPCSC. Law on Legislation, arts. 88 and 90. As discussed in 3.3. below, the Law on Legislation attempts to impose certain constraints on delegations of legislative power regarding taxation to the executive branch.
44. Fu Hongwei, "A Discussion of the Necessity and Feasibility of Giving Tax Legislative Power to Local Governments," Administrative Law Review (*xingzheng faxue yanjiu*) 2002(2), pp. 28-32.
45. The Constitution, arts. 58 and 100. The State Council and national ministries also possess law-making power, Id, arts. 89 and 90. As discussed in 2.1. above, under the Organic Law of Local Governments and the Law on Legislation, the power of local legislation has been extended to certain people's congresses and people's governments below the provincial level.
46. Fu Hongwei, "The Understanding and Evaluation of the Framework Rules for Tax Legislative Power," Taxation Research 2004(12), pp. 33-5 (at p. 34).
47. Guofa [1993]85 (State Council, Dec. 15, 1993) [Decision Regarding the Implementation of the Tax Sharing System of Fiscal Management] ("1993 Decision").

taxes must all be vested in the Central Government, so as to ensure the uniform command of the Central Government, and to maintain a uniform national market and fair competition among enterprises."[48]

It is of course unclear why any degree of decentralization of taxing power must necessarily obstruct inter-jurisdictional commerce or fair competition. As a matter of fact, the State Council left the decision whether or not to impose three minor taxes to provincial governments.[49] In any case, the 1993 Decision advanced the most stringent statement of the centralization doctrine in taxation, compared to both what the central government had stated before 1993 and what it has said since then. It also demonstrates how, within the Chinese context, delegation from the legislative to the executive branch can have important consequences for central-local fiscal relations. Through the 1993 Decision, the State Council took away not only tax legislative power from the executive branches of sub-national governments, concerning the policies of which it exercised control,[50] but also deprived provincial people's congresses of such power, even though it formally has no control over local legislatures. The fact that neither the NPC nor any local legislature challenged the legal process by which the 1994 tax reform was accomplished reflects either these legislative bodies' acquiescence, or their institutional weakness, or both.

Highlighting the point that the centralization of taxing power is by no means an inevitable or even natural consequence of the fact that China is a unitary state, the 1993 Decision leaves the systems of "fiscal management"– all affairs relating to revenue and expenditure assignments, as well as transfer payments – within provincial-level jurisdictions entirely to provincial governments to determine. The latter were only instructed to take the center-provincial arrangement as a model.[51] This act of devolution, again, occurred entirely within the executive branch, putting local legislatures out of play. The arrangement of having the executive branches of provincial governments determine intra-provincial fiscal affairs continues until today.[52]

3.3. The current ambiguous legal framework

A "decision" by the State Council has a questionable legal effect relative to national statutes and even formal regulations of the State Council.[53] Chinese legal scholars have thus tended to cite several other pieces of statutory law when discussing the allocation of taxing power. The first of these is the Law on the Administration of Tax Collection (LATC),[54] which was first enacted in 1992, before the 1994 tax reform. Article 3 of the LATC states that "the imposition

48. Id. sec. 2(3).
49. These were the slaughter tax, the banquet tax and the livestock tax. For an explicit statement of this delegation, see, e.g. Guofa [1998] 4 (State Council, Mar. 12, 1998) [Notice Regarding Strengthening Taxation according to Law and Strictly Enforcing the Scope of Tax Administration].
50. The Constitution, art. 89(14).
51. The 1993 Decision, s 4(7); see also, Caidizi [1996] 24 (MOF, Mar. 26, 1996) [Notice Regarding the Opinion of the Ministry of Finance on Improving the Tax Sharing System of Fiscal Management within Provinces].
52. See, generally, Guofa [2002] 26 (State Council, Dec. 26, 2002) [Notice Forwarding the Opinion of the Ministry of Finance on Improving the Systems of Fiscal Management below the Provincial Level]. See also discussion in 4.3. below.
53. The 1993 Decision did not have the form of a State Council "administrative regulation", and is strictly speaking an informal document. Therefore, its legal effect has long been questioned. See, e.g. Xu Shanda, *The Chinese tax legal system* (*zhongguo shuishou fazhilun*) (Taxation Press, 1997), p. 305 (cited in Liu Jianwen, "A Study of Issues in Chinese Tax Legislation," available from www.chinalawinfo.com).
54. NPC, Sep. 4, 1992, effective as amended May 1, 2001.

of a tax or the cessation thereof, the reduction, exemption, refund or additional payment of tax shall be implemented in accordance with statutes, or, if the State Council is authorized by statutes to formulate relevant provisions, in accordance with the relevant provisions prescribed in administrative regulations formulated by the State Council."[55] Very different readings have been given to this provision. Some interpret it as reserving tax legislative power entirely to the NPC and State Council.[56] Thus interpreted, the LATC would have to be viewed as setting forth a powerful doctrine of centralization even before the 1993 Decision of the State Council. However, the LATC provision was not invoked in any of the core documents of the 1994 tax reform, and part of that reform explicitly delegated the authority for the imposition or cessation of three minor taxes to provincial governments.[57] An alternative interpretation is that as long as explicit procedures are followed, tax legislative power may be further delegated to other entities, including local governments. While more consistent with actual Chinese practice, this position seems inconsistent with legislative principles. Yet another interpretation lies between the first two and holds that while the legislative power for those components enumerated in the LATC provision is reserved for the NPC and State Council, the allocation of legislative power for other components of taxes is unrestricted by the LATC.[58] It is probably fair to say that none of these conflicting interpretations prevails today.

An important piece of legislation that accompanied the 1994 tax reform, the Budget Law, makes a feeble attempt to codify the 1994 tax sharing arrangement. It states that "the nation follows the central-local tax sharing system",[59] without defining such a system.[60] All budgetary revenue (which includes tax revenue) is to be divided into three types: central, local and shared.[61] The right to classify items of budgetary revenue as belonging to central or local budgets or shared among them is given to the State Council, whose decisions in this regard only have to be "filed" with the Standing Committee of the NPC, i.e. the latter entity has no power to approve or disapprove such classification.[62] The Budget Law thus appears to have made a specific (at least compared to the blanket 1985 Delegation) statutory delegation of the decision on what taxes are central, local or shared taxes to the State Council. It makes no statement as to whether the power to impose or repeal taxes must be centralized. The Budget Law also prohibits agencies in charge of collecting budgetary revenue (including tax revenue) from using their discretion to reduce, exempt persons from, or delay the collection

55. Id. art. 3. The provision goes on to say: "No governmental organs, entities or individuals may violate laws or administrative regulations or make decisions without authorization regarding the collection of tax or the cessation thereof, the reduction, exemption, refund and additional payments of tax."
56. See Bu Yaowu, et al (Legal Affairs Commission of the NPCSC), "Annotations of the Law on the Administration of Tax Collection", available online through www.chinalawinfo.com; Xu Shanda, *The Chinese tax legal system* (*zhongguo shuishou fazhilun*) (Taxation Press, 1997), p. 51 (cited in Fu Hongwei, "A Discussion of the Necessity and Feasibility of Giving Tax Legislative Power to Local Governments," p. 30).
57. Id.
58. Id.
59. The Budget Law, art. 8.
60. In the Implementation Regulations for the Budget Law (State Council Order No. 186, published and effective Nov. 22, 1995), art. 6, the tax sharing system was defined as "allocations of budgetary revenue according to tax types and based on the allocation of administrative and expenditure responsibilities among central and local governments" – a formulation copied from the 1993 Decision on Tax Sharing. The substance of such a system was to be determined by the State Council. Id. This could not be read as an enabling provision as the State Council would be delegating to itself.
61. Budget Law, art. 20.
62. Id. art. 21.

of such revenue.[63] However, this may be narrowly interpreted as imposing an obligation on tax collection agencies, and arguably does not bar local governments from returning their shares of collected tax revenue to taxpayers as budgetary expenditures. As we will see in Section 5 below, this latter practice was to become a popular method of local tax reductions.

The most frequently cited statutory authority for the centralization of tax legislative power is the Law on Legislation ("LL") of 2000. Article 8 of the LL enumerates several categories of matters which must be governed by national statutes. Among them are "the basic economic system and basic systems of public finance, taxation, customs, finance and foreign trade."[64] However, if national statutes have not been enacted on a matter reserved for national legislation under Article 8, the NPC or its Standing Committee may authorize the State Council to adopt administrative regulations regarding the matter. The State Council may not then delegate the authorized power to any other entity.[65] These provisions imply that only the NPC or the State Council can make tax law. However, as the 1992 LATC, an important ambiguity remains – what constitute "basic" systems of taxation? The State Council has offered the following interpretation: "The issuance of money, the setting of standard interest rates, the adjustment of exchange rates, and the adjustment of rates of the main taxes and other items subject to the Central Government's macroeconomic adjustment … must all be governed by rules issued by the Central Government, and cannot be governed by local governments" (emphasis added).[66] There is an obvious element of equivocation here: perhaps it is only the "main taxes" that have to be centrally dictated, and even then, perhaps it is only the tax rates that have to be centrally dictated. In reality, the centralization of tax legislative power is far from absolute. The State Council has itself explicitly delegated many decisions on tax rates and tax base to provincial governments or even provincial tax agencies.[67] A too-comprehensive interpretation of what constitutes tax legislative power reserved exclusively to the central government would necessarily lead to the conclusion that the State Council has violated the prohibition against further delegation under Article 9 of the LL.

Further complicating the issue is that the Law on Legislation to some extent questioned the continued validity of the 1985 Delegation. The LL requires the purpose and scope of any legislative delegation under Article 8 to be clearly defined.[68] Further, it is expected that once the regulations issued under delegated authority have been tested in practice, the NPC or its Standing Committee would enact legislation in "a timely manner", at which point the delegation on the matter would terminate.[69] Both the unlimited scope and the indefinite nature of the 1985 Delegation are hard to square with these principles.

63. Id. art. 45. See also, Implementation Regulations for the Budget Law, arts. 35 (tax reductions, exemptions and delayed collections can only be provided by national statutes, State Council regulations, and rules issued by the Ministry of Finance) and 51 (finance departments on different levels of government are to sanction any unauthorized acts of reducing, exempting, delaying the collection of, or returning taxes by tax collection agencies).
64. LL. art. 8(8).
65. Id. art. 10.
66. Guofa [2000]11 (State Council, Jun. 8, 2000) (Notice Regarding Implementation of the Law on Legislation), sec. 3.
67. Provincial tax agencies are either provincial State Tax Bureaus (STBs) or Local Tax Bureaus (LTBs). The distinction between the STB and LTB systems is discussed in 4.2 infra. "Provincial governments", on the other hand, refer to the executive offices of the provincial governors, which have political control over local LTBs but not STBs.
68. The 1993 Decision, art. 10.
69. Id. art. 11.

3.4. Accepted forms of devolution of tax legislative powers

Chart 1 below, shows a number of important taxes the revenue from which is either shared between the central and local governments or allocated entirely to the latter,[70] and how various elements of the tax base and tax rates are left to the discretion of provincial governments or tax agencies. What is delegated is, strictly speaking, legislative power: the power not just to interpret and implement rules but to make rules (within specific bounds).

In view of this range of explicit, "legitimate" forms of delegation, the doctrine that tax legislative power must be centralized arguably has bite only with respect to the following issues: (1) whether local governments may impose new taxes for which there is no uniform national legislation; and (2) whether local governments have overstepped their delegated power in changing the tax base and tax rates in certain ways (including whether certain actions taken by local governments having the same effect as allowing tax reductions or exemptions should be treated as overstepping the scope of their taxing powers).[71]

Chart 1: Explicit delegations to provincial governments or tax agencies to vary the base or rate of certain major taxes

Type of tax	Items over which provincial governments or tax agencies possess discretion
VAT (shared)	– The VAT threshold (below which a business is exempted from VAT) within a prescribed range.
Individual Income Tax or IIT (shared)	– The extent and duration of tax reductions for the disabled, the elderly without family, families of martyrs, those suffering heavy losses from serious natural calamities, or other IIT reductions permitted under IIT Law art. 5.
Enterprise Income Tax or EIT (shared)	– The amounts of certain mandatory employment benefits which in turn would be used as limits within which the payment of such benefits would be deductible.
Business Tax or BT (local)	– BT threshold within a certain prescribed range of monthly revenue; – BT rate for entertainment services within a certain range (5%-20%); and – Profit percentage in applying cost-plus method for estimating revenue.
Deed Tax (local)	– The tax rate, within the 3%-5% range; – Whether it is the local finance bureaus or LTBs that will collect the deed tax, or whether some other agencies may be entrusted with collection; – The precise scope of certain exempt types of property (for government, education, healthcare, scientific research, or military use); – Whether the re-purchase of government-requisitioned property is taxable; and – Detailed implementation rules.
Urban Land Use Tax (local)	– The organization of measurement of taxable acreage; – Tax rates within quite varied ranges, and different rates for different classes of land; – Rate reductions or increases beyond the prescribed range, subject to MOF approval; – Reductions for those unable to pay, conditional on approval of the SAT; – Taxable period; and – Detailed implementation rules.

70. For the revenue contribution of these taxes to overall tax revenue, see column 2 of Chart 2 in 3.1, infra. The tax sharing system is discussed in 4 below.

71. Contrast this summary with that provided in Ehtisham Ahmad, "Taxation Reforms and the Sequencing of Intergovernmental Reforms in China," in Lou and Wang, Public Finance in China, pp. 112-3, which portrays a much smaller degree of local discretion over the bases and rates of various taxes.

Type of tax	items over which provincial governments or tax agencies possess discretion
Real Estate Tax (local)	– Extent (between 10% and 30%) to which taxable value may be reduced in computing tax liability; – Tax reductions or exemptions for taxpayers "truly experiencing difficulties"; – Taxable period within a year; and – Detailed implementation rules.
Land Appreciation Tax or LAT (local)	– Certain expenses are deductible in computing the taxable amount to the extent of a maximal percentage of other costs. The actual percentage within the maximum is determined by provincial governments; – The standard for "ordinary residence"–the selling of which is eligible for an exemption for an initial 20% of return on cost; and – Methods for prepaying LAT where property is transferred before construction is completed (in practice, supposed prepayments often ended up being final payments).

In summary, while the centralization doctrine regarding tax legislative power has some statutory basis, it is not free from ambiguities. More importantly, the doctrine must be seen against the background of weak constitutional guidance regarding taxation and fundamentally problematic delegation to the executive branch. Moreover, the rationale for centralization has not been sufficiently articulated. In Section 5, we will see that the central and local governments have continued to tussle over local tax policy initiatives. The outcomes of such tussles are not determined by courts, but like case law, they shed light on the likelihood of rules being followed.

4. The Tax Sharing Arrangement

Even though the tax sharing system was established in 1993 by an executive fiat, and even though it is debatable whether the action was sufficiently authorized by the NPC, the system fundamentally shapes the dynamics of fiscal federalism in China. For one thing, any tax legislation, especially one that has substantial impact on revenue, is likely to presuppose some political agreement (or expectation of such an agreement) about whether the revenue consequences for local governments are tolerable within the then-applicable tax sharing system.[72] Moreover, whether a tax (or a component of a tax) is collected by tax agencies controlled by the central or local governments affects local governments' ability to influence the impact of tax policy through administrative discretion. Furthermore, some local governments have taken the position that they are entitled to adopt what are effectively tax exemptions or reductions with respect to their shares of a particular type of tax revenue. Therefore, this section summarizes the tax sharing system.

4.1. The division of tax revenue

The classification of taxes into central, shared and local taxes in 1993 were said to be based on the following considerations: central taxes were those "necessary for protecting national interest and implementing macroeconomic control;" shared taxes were "major taxes directly linked to economic development;" and local taxes were those "suitable for local administration." Moreover, it was expected that an ample variety of local taxes would be put into legislation in order to increase local revenue.[73] Accordingly:

72. As we saw in the last section, the Budget Law and the Law on Legislation imply, whether or not intentionally, that the division of tax revenue is not a tax matter insofar as the Law on Legislation is concerned.
73. Id. sec. 3(2).

- Revenue from the following taxes were allocated entirely to the central government: tariff; VAT and excise tax[74] collected at customs; excise tax; enterprise income tax (EIT) collected from centrally-owned SOEs and banks and other financial institutions; business tax (BT) collected from the nationally-operated railroad system, and headquarters of banks and insurance companies. The center also took on full responsibility for export refunds (due to complete or partial zero rating under the VAT)
- Revenue from the following taxes would be shared: VAT (75% to the center); stamp duty on securities transactions (50% to the center); resource tax (the offshore petroleum portion to the center, the rest to provinces).
- Revenue from the following taxes would go to local governments: BT and EIT (except where reserved for the center, as described above); individual income tax (IIT); urban land use tax; urban maintenance and construction tax; real property tax; vehicle use tax; other stamp duty; tax on occupation of agricultural land; deed tax; land appreciation tax; and several taxes that were either subsequently repealed or never enacted.[75]

This division of revenue did not in fact determine the actual revenue distribution at the outset, thanks to what would become a standard technique adopted by Chinese political leaders to achieve consensus on tax reforms: any new allocation of revenue would not reduce the previous amount of receipt by local jurisdictions; instead, the central government would return revenue to local governments to guarantee the latter at least as much revenue as was received before the new allocation took effect, and sometimes more.[76] In 1994, for example, the amount of VAT and excise tax revenue that would be returned to provincial governments was determined by reference to revenue collected in 1993.[77] And in subsequent years, revenue returned to any given province would increase at 30% of the rate at which combined VAT and excise tax revenue grew in that province.[78] Because the central government took the greater share of growth in these two taxes, over time its shares would approach the intended 75% and 100% ratio, and the importance of the revenue returned mechanism would diminish. Nonetheless, the mechanism partially undermined the redistributive function of centralization, by requiring the center to make transfer payments to the more prosperous provinces.[79]

The 1993 revenue allocation went through numerous subsequent adjustments, most of which were in favour of the center. Most importantly, the center came to share all EIT and PIT revenue with the provinces (50% in 2002 and 60% in 2003 and onwards), while keeping EIT revenue collected from the railroad and postal systems, the major national-level banks,

74. The excise tax, imposed on select commodities (e.g. luxury goods, finished oil, automobiles, tobacco, etc) at different rates, is labeled "consumption tax" *(xiaofei shui)* in Chinese terminology.
75. Those repealed include certain agricultural taxes, the slaughter tax, the banquet tax, and a tax on fixed asset investment; the gift and estate tax was never enacted.
76. Such political agreements regarding revenue baselines were reached entirely outside the legislative branch, and through joint coordination by the executive branch and the Communist Party system. See Liu and Jia, *Thirty years*, chapter 8.
77. For the precise formula, see Li Ping and Xu Hongcai (eds), *Chinese intergovernmental fiscal relations: illustrations and annotations* (Public Finance and Economics Press, 2006), pp. 24-5.
78. Guofa [1994] 47 (State Council, Aug. 24, 1994) [Notice Regarding a Change to the Tax Sharing System of Fiscal Management by Linking Revenue Returned to Regional Growth of VAT and Excise Tax].
79. For discussions of these "tax rebates", see Anwar Shah and Chunli Shen, "Fine-Tuning the Intergovernmental Transfer System to Create a Harmonious Society and a Level Playing Field for Regional Development," in Lou and Wang, *Public finance in China*, pp. 131-135; Ehtisham Ahmad, "Taxation Reforms and the Sequencing of Intergovernmental Reforms in China," id. pp. 107-110.

and some of the largest oil and gas producers to itself. The resulting increase in revenue for the center was ear-marked for transfers to poor western provinces.[80] Due to this reallocation, in 2005, the center claimed 7% of total income tax revenue as its own exclusive revenue, and 56% of the total income tax revenue as its portion of shared income taxes. However, because the increased allocation of income tax revenue to the center was also accomplished politically through a revenue-return arrangement, which protected the baseline income tax revenue received by the provinces in 2001, the provinces' actual share of the total income tax revenue has been greater than what the nominal allocation would imply. For example, it was 66% in 2005.[81]

Other significant post-1994 adjustments include:[82]

- The center's share of stamp duty on securities transactions increased to 88% in 1997 and further to 97% in 2000, at the expense of Shanghai and Shenzhen, the two cities where China's major securities exchanges are located.
- The center's share of VAT export refunds was reduced from 100% to 75% in 2004 for any incremental amount over a 2003 baseline. This percentage increased to 92.5% in 2005.
- A new vehicle purchase tax was enacted in 2000 and made an exclusively central tax.[83]
- In 2009, six types of local transportation fees were abolished and replaced by an added category within the excise tax, the revenue of which is allocated to the center (although revenue is returned to the provinces by reference to a 2007 baseline).[84]
- The center's share of BT revenue from financial and insurance institutions temporarily increased between 1997 and 2003.

These allocation changes may give a strong impression that the central government steadily encroached upon provincial governments' revenue shares after 1994, and this perception is widely shared in China. Based on the government's statistics, however, the center's nominal share of fiscal revenue – before any revenue returned to provinces – reached an immediate high of 55.7% in 1994 and since then has fluctuated below that and 49%. In other words, there is no linear increase in the center's percentage of total revenue as allocated. This is probably because the composition of tax revenue changed over time in favour of the local taxes, especially real estate related taxes. These local taxes grew faster than tax revenue in general and compensated for the diminishment of the provincial allocation percentage of shared taxes. On the other hand, the center's share of total tax revenue increased almost linearly after taking revenue returned to the provinces into account: this share went from 21.2% in 1994 to 40.4% in 2005.[85] This is likely explicable in terms of the rapid growth of overall

80. Guofa [2001]37 (State Council, Dec. 31, 2001) [Plan for Reforming the Sharing of Income Tax Revenue].
81. Li and Xu, *Chinese intergovernmental fiscal relations: illustrations and annotations*, pp. 28-32.
82. See, id, pp. 27-35.
83. Provisional Regulations on the Vehicle Purchase Tax (State Council Order No. 294, Oct. 12, 2000, effective Jan. 1, 2001); Caiyu [2001]40 (MOF and SAT, Jan. 21, 2001) [Notice Regarding Budgetary Issues for the Vehicle Purchase Tax].
84. Guofa [2008]37 (State Council, Dec. 18, 2008) [Notice Regarding Implementing the Reform of Product Oil Prices and Certain Tax and Fees].
85. Li and Xu, *Chinese intergovernmental fiscal relations: illustrations and annotations*, pp. 36. In 2009, this percentage was 48.5% (author's computation based on the Report of the MOF on the Implementation of the 2009 Central and Local Budgetary Plans (Mar. 5, 2010, hereinafter the "2009 Budget"), available in Chinese at http://news.xinhuanet.com/politics/2010-03/16/content_13181369.htm).

tax revenue, relative to which the amount of tax revenue returned to provinces diminished substantially. In other words, the central government's share of tax revenue has grown as the pre-1993 status quo (which favoured local governments) is left further behind, despite the increasing revenue importance of local taxes in recent years.

Chart 2 below summarizes the result of the foregoing tax sharing arrangements for provincial governments in 2009, given the composition of tax revenues.

Chart 2: Tax Revenue Composition in 2009 and Resulting Revenue Share for Provincial Governments[a]		
Type of Tax	**% of total tax revenue in 2009**	**Provincial % of tax**
Domestic VAT (net of export refund)	20.15	25
Enterprise income tax	19.38	(<) 40
Business tax	15.15	(<) 100
VAT and excise on import	12.99	0
Domestic excise	8.00	0
Personal income tax	6.64	40
Deed tax	2.92	100
Tariff	2.49	0
Vehicle and vessel purchase tax	1.95	0
Urban land use tax	1.55	100
Real estate tax	1.35	100
Land appreciation tax	1.21	100
Tax on use of agricultural land	1.06	100
Stamp tax on securities transactions	0.86	3
Resource tax	0.57	(<) 100
Other	3.74	100
Provincial share of tax revenue not taking into account revenue return mechanisms		(<) 43.02
a Author's computation based on the 2009 Budget.		

4.2. The division of tax administration

Just as important as the classification of central, shared and local taxes and the decision regarding the allocation percentages for the shared taxes is the division of tax administration. In connection with tax sharing, in 1993 the State Council established a bifurcated system of tax administration that comprised two subsystems: the state tax bureaus (STBs) and local tax bureaus (LTBs).[86] The STB system is operated under the unified leadership of the State Administration of Taxation (SAT), and is divided into a hierarchy of four levels: the SAT, provincial STBs, prefecture/municipal-level STBs, and county-level STBs.[87] Within the hierarchy, each of the lower three ranks reports to the next rank above. STBs at each rank determine the set-up of internal divisions, personnel, budgets and the appointment of bureau chiefs of STBs at the next lower rank within their geographic jurisdictions.[88] LTBs at

86. See Guobanfa [1993]87 (State Council General Office, Dec. 9, 1993) [Notice Regarding Distribution of the Practical Recommendations of the State Administration of Taxation for the Organization and Establishment of Directly Affiliated Tax Agencies in Local Jurisdictions and of Local Tax Bureaus] ["1993 Tax Administration Circular"].
87. Id., sec. 2(2).
88. Id., sec. 2(3).

provincial and lower levels, by contrast, operate in accordance with local government organization laws, and personnel, budget, and appointment matters are generally determined by local governments at the same level.[89] Although the SAT is supposed to exercise some control over the provincial LTBs, its authority to do so is subordinate to that of the provincial governments.[90] More specifically, the SAT is to provide tax policy and technical guidance, coordinate with LTBs to ensure the uniform implementation of the tax system and tax policies, and organize the exchange of information and experience; the heads of provincial LTBs can be appointed only after the approval of SAT is obtained; and the SAT is to be copied on tax plans and tax statistics submitted by LTBs to their respective local governments.[91]

In 1993, the State Council initially put the STB system in charge of the collection of not only the central taxes, but also all taxes due from all sellers in market fairs and sole proprietors, from foreign-invested enterprises (FIEs) and foreign enterprises, as well as IIT due from foreigners,which were all marked as local taxes.[92] The resistance encountered by this administrative allocation powerfully illustrates the importance to local governments of controlling tax collection. Many local jurisdictions refused to allow this encroachment on their power to collect what were local taxes; instead, they divided the collection of taxes from FIEs, foreign enterprises and individuals, and small traders among STBs and LTBs in accordance with tax types. The State Council had to issue a special circular in 1994 urging local governments to "have faith" that taxes collected by STBs would be properly shared with local governments, in accordance with the tax sharing percentages determined in 1993.[93] Nonetheless, ultimately it was the central government that backed down, and the right to collect local taxes from FIEs, foreign enterprises and individuals, and small traders was handed back to LTBs in 1996.[94]

Why did this fight occur? If local governments were guaranteed their proper shares in the revenue of a particular type of tax but did not have to bear the administrative cost of collecting that tax, why would they object?[95] It may be that local governments did not believe that the STBs had the competence to collect local taxes effectively. But an equally important possibility is that the control of tax administration implies the power to control effective tax rates, and local governments were (and still are) interested in such control.[96] This latter possibility is supported by evidence from a later adjustment of administrative division of labour, which took place after the central-provincial income tax sharing percentage was changed in favour of the center in 2002. That reform triggered a re-allocation of EIT collection responsibility among STBs and LTBs. Previously, STBs were responsible for EIT collection from

89. Id. sec. 2(2).
90. Id. sec. 2(3).
91. Id. sec. 2(4).
92. Id. sec. 2(1).
93. Guobanfa [1994] 100 (State Council General Office, Nov. 9, 1994) [Notice Regarding Distribution of the Request of the State Administration of Taxation for Diligently Implementing the Division of Labour in Tax Administration among Central and Local Tax Agencies].
94. See Guobanfa [1996] 4 (State Council General Office, Jan. 24, 1996) [Notice Forwarding the Opinion of the State Administration of Taxation Regarding Adjusting the Respective Scope of Tax Administration of State and Local Tax Bureaus].
95. It was unclear whether, under the arrangement of Guobanfa [1994] 100, supra note 94, the additional cost of collection for the STB due to administering local taxes for select taxpayers was passed on to the local governments (by reducing the amount of revenue transferred to the latter). If this was the case, then local governments may object for the bureaucratic reason that they bore the (uncontrolled) cost of other agencies, especially the cost of personnel.
96. Control of administrative power may also bring about rent-seeking opportunities, but presumably the local governments themselves are less interested in this than staff members of LTBs.

centrally-owned SOEs, FIEs, and certain special types of taxpayers (e.g. banks and financial institutions), whereas LTBs were responsible for EIT collection from others. Both systems, thus, had competence at EIT collection. The SAT announced in 2002 that while the division of labour among STBs and LTBs in terms of EIT collection with respect to taxpayers that existed as of the end of 2001 was to be kept unchanged, new businesses opening after 2001 would be subject to the administration of STBs for EIT purposes.[97] However, if businesses previously subject to the jurisdiction of LTBs were to reorganize and re-register, they would continue to be subject to LTB administration. The partial preservation of the jurisdiction of LTBs has been interpreted as a concession to local governments. Indeed, the central government was explicitly concerned whether STBs and LTBs would be able to administer EIT law and policy in a consistent manner (even in a single jurisdiction). The SAT warned of how the lack of consistency could create unfairness and undermine the authority of tax agencies,[98] and specifically highlighted the possibility that tax collectors may use discretion in the practice of presumptive taxation and deliberately under-tax certain businesses.[99]

Although the SAT was not explicit about which type of agency, the STBs or LTBs, is more likely to adopt lenient tax policies, experience suggests that the LTBs have much greater incentive to do so. In short, whoever controls tax collection – a centrally- or locally-responsible tax office – partially determines the extent to which local governments control the actual implementation of tax policy, and, therefore, the scope of tax competition, even in the absence of tax legislative power.

Overall, however, there has been no trend in recent years towards centralizing tax administration in China. In 2008, collection jurisdiction for the EIT was re-allocated "in favour" of local governments: new enterprises formed in 2009 or after would not automatically fall under the jurisdiction of STBs for EIT purposes. Instead, STBs would administer EIT for those enterprises that pay VAT, and LTBs would administer EIT for businesses that pay BT (or neither VAT nor BT).[100] This decision was probably based on efficiency considerations (e.g. facilitating cross-auditing of income and indirect taxes), although presumably a judgment was also made that there was now sufficient consistency among STBs and LTBs in EIT enforcement.

4.3. Tax sharing below the provincial level

According to the 1993 Decision of the State Council, the principles and aims of tax sharing are the following: the system would, "on the basis of the allocation of responsibilities among central and local governments, appropriately determine the scope of expenditures of different levels of government; on the basis of matching expenditures and revenues, divide various taxes into central government taxes, local government taxes, and center-local shared taxes,

97. Guoshuifa [2002]8 (SAT, Sep. 27, 2002) [Notice Regarding Issues in the Scope of Tax Administration after the Reform of the Tax Sharing System for the Income Taxes].
98. Guoshuifa [2002]120 (SAT, Sep. 12, 2002) [Notice Regarding Further Improving Tax Administration after the Reform of the Tax Sharing System for the Income Taxes], sec. 3.
99. Id. sec. 4. See, also, Guoshuifa [2003]76 (SAT, Jun. 25, 2003) [Supplemental Notice Regarding the Scope of Tax Administration after the Reform of the Tax Sharing System for the Income Taxes] ("STBs and LTBs … should, within their respective scopes of administration, strengthen cooperation, and enhance communication, coordination and consultation regarding the implementation of various EIT policies and the use of presumptive taxation, and strictly enforce tax reduction or exemption policies under the EIT, in order to ensure the consistency and seriousness with which tax law is implemented.")
100. Guoshuifa [2008]120 (SAT, Dec. 16, 2008) [Notice Regarding Issues in Adjusting the Scope of Income Tax Administration for New Enterprises].

and create central and local tax administrations to administer the central and local systems of taxes separately; scientifically determine the amount of local revenue and expenditure, and gradually implement a relatively standardized system of revenue return and transfer payments from the center to local governments; and establish and improve government budgeting at different levels, and strengthen budgetary constraints."[101] Local governments were to follow these principles to implement similar tax-sharing systems among the different levels of government within their own jurisdictions.

In practice, provinces have adopted fairly diverse approaches for tax sharing within their jurisdictions.[102] Most provinces share the revenue from the larger taxes (the local share of VAT, IIT and EIT, and BT) with prefectures/municipalities, or directly with counties. Fifteen provinces adopt a proportional scheme for such sharing, where the provincial jurisdiction takes the smaller percentage (from 30% to 50%), perhaps in recognition of the heavier expenditure responsibilities of lower-level governments. Four provinces practice such sharing by allocating business taxpayers between provincial and lower governments, while the other provinces adopt a mixture of proportional sharing and sharing by allocation of taxpayers. Some smaller taxes (e.g. resource tax, urban construction tax, stamp duty, etc.) are exclusively allocated to the prefecture or county levels. In some jurisdictions, the provincial government claims the (non-central-portion of) revenue from all or some taxes paid by certain industries. For example, 20 provinces claim the entire BT revenue collected from financial institutions for the provincial budget. The aggregate result of this is that in 2005, provincial governments receive 24.6% of the total local revenue (compared to 17.1% in 1994), whereas county and township governments receive 38.6% (compared to 41.8% in 1994); the remainder is revenue received by prefectures (36.7% in 2005 and 41.0% in 1994).[103]

A recent report highlighted inter-provincial diversity. In 2009, the provincial government's share in the total budgetary revenue for Guangdong Province was only 19.9%, "lower than the national average of 23.5% and the 23.8% average for the eastern China region, [as well as the provincial share in Guangdong] before the 2001 income tax sharing reform, which had been 26.7".[104] Starting in 2011, Guangdong raised the provincial percentage for province-county tax sharing from 40% to 50%, so as to allow the provincial government to make more equalization transfers to poorer regions in the province. The shared taxes included the local portions of the EIT and IIT, the BT paid by non-financial institutions, and the land appreciation tax. By contrast, in 2009, Hunan Province allocated the previously shared Land Appreciation Tax and Urban Land Use Tax entirely to prefecture/county levels, and increased the latter's shares of VAT, BT and the resource tax to 75%. Starting in 2011, Hubei Province also allocated many shared taxes to lower levels of government.[105]

5. Forms of Decentralization in a Centralized System

Especially because of the strong incentives local politicians face for promoting economic growth, local governments in China, like local governments elsewhere, often try to offer tax

101. 1993 Decision on Tax Sharing, sec. 1.
102. Li and Xu, *Chinese intergovernmental fiscal relations: illustrations and annotations*, p. 134.
103. Id. p. 148.
104. "Guangdong reforms province-county tax sharing, provincial share raised to 50%," 21st Century Economic News, Jan. 12, 2011. The 2001 income tax sharing reform is one of the national/provincial centralization measures discussed in the text accompanying notes 80-81 supra.
105. Id.

incentives to attract investment and nurture home-grown business. This would of course be impossible within a rigidly centralized tax system. Just how rigid the current system is in controlling local tax preferences is a topic that requires careful study. For the last two decades, hardly a year has gone by without some State Council, MOF or SAT announcement chastising local non-compliance with the centrally-dictated tax order.[106] The periodic campaigns and crackdowns evidence more a state of disequilibrium.

5.1. Periodic crackdowns on local tax preferences and continuous negotiations

Even before the State Council formally centralized tax legislative power in 1993-4, there had already been a long history of the central government trying to curtail local tax preferences. These local preferences may not only have created harmful competition, and may have been enacted in combination with local protectionist measures, but given that, before 1994, the central government's fiscal capacity largely depended on local governments' remittance of revenue (as opposed to collection by the centrally-controlled STB system), they directly threatened the revenue intake of the central government itself. In July 1993, on the eve of tax reform, the State Council ordered a national review of unauthorized preferential policies, and a year later the MOF and SAT reported 5,096 such policy items, resulting in a revenue loss of 5.35 billion yuan in 1993, over 1% of the total tax revenue collected during that year.[107]

Numerous central government decrees followed the 1993 Decision on Tax Sharing and targeted local tax preferences, claiming that they represented an unlawful encroachment on the central government's rights.[108] In March 1998, the State Council launched a nationwide campaign to identify systematically explicit and disguised unauthorized tax preferences. The notice announcing the campaign (the "1998 State Council Notice")[109] identified a range of problematic local practices, including, besides unauthorized grants of exemptions and reductions, grants of delayed payment or collection, tax amnesties, agreements for fixed payments (as a concessionary measure), accelerated collection, and deliberately mislabeling central tax revenue as local tax revenue. The notice claimed that one of the major achievements of the 1994 tax reform was to cut back on local tax preferences, and re-emphasized that local governments did not have the right to make or interpret tax law without authorization. Local governments may make recommendations for changes in tax policy, but could not, before the State Council made a decision, implement such changes.[110]

106. For examples of these in recent years, *Guoshuifa* [2008]73 (SAT, Jul. 17, 2008) [Notice on Adhering to Administering Tax by Law and Strictly Administering Tax Reductions and Exemptions]; *Guoshuihan* [2008]1049 (SAT, Dec. 23, 2008) [Urgent Notice on the Strict Prohibition of Pre-collection of 2009 Taxes]; *Caishui* [2009]1(MOF and SAT, Jan. 19, 2009) [Notice on Resolutely Curbing Unauthorized Tax Reductions and Exemptions and Strengthening the Tax Administration according to Law] (claiming that some local governments have used the "international financial crisis" as an excuse for unauthorized tax reductions).
107. Caishuizi [1994]45 (MOF and SAT, Jul. 1, 1994)[Notice Regarding Opinions on the Clean-up of Unauthorized Tax Reductions and Exemptions]. The total national tax revenue during 1993 was 425.5 billion yuan, and it was regarded as unusually high because of local governments' anticipation of the major reform in 1994.
108. See, e.g. Guofa [1994]24 (State Council, Apr. 19, 1994) [Notice on the Issue of Strictly Controlling the Reduction and Exemption of Import Taxes]; Guobanfa [1994]81 (General Office of the State Council, Jun. 24, 1994) [Notice on Forwarding the Opinions of the Ministry of Finance and the State Administration of Taxation on Strengthening the Collection of Individual Income Tax].
109. Guofa [1998]4 (State Council, Mar. 12, 1998) [Notice on Strengthening Tax Administration according to Law and Strictly Delineating Tax Administration Powers].
110. The offer to consider the opinions of local governments seems to be a mere invitation for the latter to voluntarily propose good national tax policy.

By the late 1990s, the central government had come to view even those local tax preferences that do not (directly) affect the central government, and only reduce local tax revenue, as unacceptable.[111] In 2000, it launched another campaign to crack down on "refund after collection" (xianzheng houfan, or RAC) and other disguised local tax reductions. RAC was a widely deployed mechanism where the government returns tax revenue collected from a particular taxpayer to that taxpayer, where the tax collected is recorded as a revenue item and the refund as an expenditure. RAC could serve as a means of local tax reduction when a local government first collects taxes in accordance with centrally-dictated laws and regulations, and then returns all or part of the local share of the revenue to the taxpayer, claiming this as an expenditure item. Between 2000 and 2002, the State Council launched a very public campaign against local RAC policies. The campaign began with a stern notice from the State Council in January 2000 (the "2000 State Council Notice"),[112] which claimed that local RAC practices "caused disorders in taxation, violated the principles of consistency in tax policy and centralization of taxing power, went against the needs of public finance, weakened the impact of fiscal policy, and created potential fiscal risks." The notice ordered all local governments to end such policies from the beginning of 2000, and stated that if a local jurisdiction failed to end such practice, the central government would reduce transfer payments and other targeted subsidies for that jurisdiction as well as "hold relevant persons accountable."

After two years of investigations and negotiations, the State Council delivered a remarkable document in January 2002, publicly reprimanding eight of the nine provincial jurisdictions that had been investigated for either failing to comply fully with the 2000 State Council Notice or failing to stop subordinate jurisdictions from non-compliance.[113] The harshly-worded document claimed that such instances of non-compliance "severely disturbed the fiscal order, and harmed the unification of national tax policy." Seven provinces and their subordinate jurisdictions were reported to have failed to halt a total of 30 items of RAC policies dating from before 2000, with the result that 2149 enterprises received a total of 1.193 billion yuan worth of tax reductions, exemptions and rebates in 2000.[114] In addition, seven provinces or their subdivisions initiated a total of 29 new preferential (including RAC) policies after the 2000, resulting in 5.46 million yuan improperly returned to taxpayers. The relatively small amount of these latter violations makes the decision to publicly reprimand even more notable.[115] The State Council claimed that the offending jurisdictions were penalized in accordance with the 2000 State Council Notice– amounts were deducted from transfer payments and subsidies, and the SAT reprimanded individuals within its own scope of authority.

Such public gestures, however, were to have no lasting effect. Although the national campaign to end unauthorized preferences lasted well into the middle of the decade, even a very

111. *Guoshuifa* [2002]120 (SAT, Sep. 12, 2002) [Notice Regarding Further Improving Tax Administration after the Reform of the Tax Sharing System for the Income Taxes].
112. Guofa [2000]2 (State Council, Jan. 11, 2000) [Notice Regarding Correcting the Unauthorized Adoption of Refund after Collection Policies].
113. Guobanfa [2002]5 (General Office of the State Council, Jan. 16, 2002) [Notification Concerning the Illegal Adoption of "Refund after Collection" and Other Policies of Tax Deduction and Exemption in Some Jurisdictions].
114. Specific examples named included Jilin Province's agreement to a fixed tax payment by a provincial SOE, Dalian City's (in Liaoning province) offering of tax preferences that had been allowed FIEs to domestically-owned enterprises, Shanghai's grant of tax exemptions to four "high technology" enterprises, and similar preferences offered by Fujian province to certain high-technology enterprises.
115. Total tax revenue in China in 2000 was 1.266 trillion yuan.

casual survey of local practices adopted since 2005 and directed at just one sector, namely financial service and investment firms, points to the central government's tenuous policy hold:

- In 2005, the City of Beijing adopted, as part of a larger package to encourage the development of the financial service industry in the city and among other tax-related measures, a rule according to which any senior manager employed in a financial firm for over two years may receive a "bonus" from the government equal to 80% of the local share of the previous year's IIT payments.[116]
- In 2007, the City of Tianjin offered a 3-year tax rebate of 50% of the local portion of EIT collected from newly-established venture capital companies that invest in logistics or high technology firms; certain other entities providing training or information in financial services were granted similar benefits, as well as 3 years of rebate of 50% of Business Tax paid.[117]
- In 2009, the Shanghai City Government offered a 50% deed tax rebate to certain financial service firms, and provided that individuals deemed to possess financial talents would also receive certain "bonuses".[118] These bonuses were widely reported to be refunds of tax payments, but in fear more of social controversies over giving money to the already rich than of revealing legal improprieties, the documents specifying the nature and amount of such bonuses were kept secret.[119]
- During the same year, the Pudong District (a special development zone) in Shanghai announced that 40% of all "fiscal capacity" generated by the salary income of high-level executives of private equity firms would be given back to such executives as "subsidies"; the percentage is lowered to 20% for "core investment personnel". Moreover, 50% of all local fiscal revenue generated from the investment returns made by PE firms from certain investment targets in Pudong would be rebated to the PE firms as "awards".[120]
- Also in 2008, Beijing announced that for certain asset management companies that are subject to the EIT, the portion of their EIT revenue that is claimed by county-level governments would be rebated 100% for two years as an "award", and rebated at a 50% rate for three subsequent years.[121]
- Shenzhen announced in 2010 that if a private equity fund invests in a Shenzhen entity or project, then it may be entitled to a one-time bonus equal to 30% of the "local fiscal

116. *Jingfagai* [2005]2736 (Beijing Development and Reform Commission, 2005) [Detailed Rules Implementing the "Opinion Regarding the Promotion of the Financial Industry in the Capital].
117. *Jinzhengfa* [2007]93 (Tianjin Municipal Government, Dec. 14, 2007) [Notice Forwarding the Recommendations of the Municipal Financial Services Office Regarding the Promotion of the Private Economy].
118. Hufufa [2009]40) (Shanghai City People's Government, Aug. 4, 2009) [Certain Regulations regarding Concentrating Financial Resources, Enhancing Financial Services, and Promoting the Development of the Financial Industry].
119. See e.g. http://big5.xinhuanet.com/gate/big5/sh.xinhuanet.com/2009-12/04/content_18408022.htm and http://www.cywh.gov.cn/news/cyfx/2009/12/09127839207792.html for examples of such reports in Chinese.
120. Pudong New District, Implementation Measures for Promoting the Development of Equity Investment Companies and Equity Investment Management Companies (Mar. 30, 2009). The measures are effective until the end of 2010.
121. *Jingjinrongban* [2009]5 (Office of the Beijing City Financial Services Affairs Leading Group and 4 other agencies, Apr. , 2009) [Opinions Regarding Promoting the Development of Equity Investment Funds].

capacity" created upon "exit" from the investment, subject to a 3 million yuan cap per investment.[122]

The policies of the Chongqing City government in the real estate sector offer another dramatic example. In May 2008, Chongqing announced a set of measures to promote the housing market that included: a 50% immediate refund of Business Tax paid on real estate sales pursuant to certain promotional events; a 50% reduction in deed tax on such sales, which took the effective rate below the lower end of the 1-3% range allowed under State Council regulations; and a broad expansion of preferential EIT rates beyond the sectors contemplated under State Council regulations.[123] In December 2008, Chongqing further announced that, for certain approved business reorganizations, the local portion of all taxes collectible on reorganization transactions would be refunded. Moreover, principal and interest payments on mortgages made by individuals who purchase residential housing for the first time may be credited against the local portion of IIT liabilities of such individuals.[124] This last policy received national press attention, and was compared to similar policies adopted by Shanghai during the period from 1998 to 2002.[125] In January 2009, just before the MOF/SAT announced their next crackdown on local preferential policies, Chongqing introduced a further slew of BT and deed tax reductions, which went well beyond what central government tax regulations permitted. The City further specified the first-time housing purchase IIT rebate policy, which was to last from December 1, 2008 to December 31, 2012.[126]

It appears that Chongqing was able to pursue this policy with impunity. One newspaper at the time reported that the MOF was ready to stop Chongqing, but later issued a public apology explaining that the MOF had merely "made a telephone inquiry" to Chongqing.[127] Whatever the content of that inquiry, in 2010, Chongqing re-announced the IIT RAC policy first published in 2008.[128] This suggests that quite a number of local jurisdictions believe today that RAC and even other explicit, unauthorized reductions and exemptions are fair game, notwithstanding the mantra of centralization from the MOF, SAT, or even the State Council.

5.2. Local initiatives other than tax reductions

It would be inaccurate to depict local governments in China as interested only in tax reductions where local tax policy initiatives are concerned. Such governments must raise revenue to fund their own operations, provide public services, and match central government grants. The imposition of miscellaneous, often extra-budgetary fees to supplement tax revenue has long been practiced. Also, through the exercise of administrative discretion in collection (e.g. by accelerating collection and delaying or denying proper refunds), tax agencies can increase

122. *Shenfu* [2010]103 (Shenzheng Municipal Government, Jul. 9, 2010) [Certain Rules Regarding the Promotion of the Development of the Private Equity Fund Industry].
123. *Yufufa* [2008]61 (Chongqing Municipal Government, May 31, 2008) [Notice Regarding Adopting Adaptive Policy Measures to Promote Steady and Relatively Fast Economic Development].
124. *Yufufa* [2008]132 (Chongqing Municipal Government, Dec. 18, 2008) [Opinion Regarding Further Adopting Adaptive Policy Measures to Promote Steady and Relatively Fast Economic Development].
125. See, e.g. "Chongqing Lays Out Tax Refund Policy for Apartment Purchases to Stimulate the Housing Market", Caijing, Jan. 21, 2009 (available at http://www.caijing.com.cn/2009-01-21/110050447.html).
126. *Yufufa* [2009]9 (Chongqing Municipal Government, Dec. 18, 2008) [Implementation Opinions Regarding Expanding Domestic Demand and Promoting the Healthy Development of the Real Estate Sector].
127. Editor's Explanation, China Business News, Feb. 4, 2009, p. A2.
128. See report reproduced at the Chongqing Municipal Government website, "Purchasers of Housing in the City Center with Mortgages Will Receive Subsidies" (http://www.cq.gov.cn/today/news/248001.htm).

actual tax burden to a certain extent. Interestingly, however, Chinese local governments for the most part seem not to have pursued tax policies per se that are aimed at increasing revenue beyond what central tax laws and regulations would permit to be collected. In other words, there is no analogue, in their efforts to raise revenue, to the rampant use of tax preferences described in the last two subsections. Instead, where local governments do express a willingness to pursue higher or new taxes, they seem motivated by non-revenue purposes.

In 2010, for example, four provinces were reported to have made offers to the central government to pursue trial implementation of environmental tax measures, which could involve the imposition of new taxes.[129] Their incentives for doing so are interesting. For example, Jiangxi had proposed and received approval for an ecological development zone for the Fanyang Lake area in its jurisdiction in 2009, in order to get a large "national strategy" grant from the State Council.[130] And the idea of adopting environmental taxes was part of the proposal. Hubei and Hunan are also engaged in building large economic development zones for which national grants or administrative preferences may be sought. However, because the offer of the provinces was for the central government to design environmental tax measures and simply for them to make trial implementations, the initiative is reported to have been bogged down because of an inter-agency turf fight (between the environmental ministry, the MOF and the SAT) at the central government level.

Reports in 2010 of certain cities proposing to impose new property taxes offer another set of examples. These proposals came in two varieties. On the one hand, some jurisdictions may have advanced their own designs. Chongqing was reported to have submitted a proposal to the State Council for imposing a special consumption tax on purchases of high-end housing in Chongqing,[131] while Shanghai suggested a property tax for itself instead.[132] In both cases, the aim was not to raise revenue but to create specific incentives or disincentives for market behaviour. On the other hand, other cities including Hangzhou and Shenzhen (both of which have long been centers of the real estate boom) actively pursued mandates from the MOF and SAT to develop assessment systems to be used in the future implementation of a property tax. Not only did they succeed in building such systems, they also used them to improve the administration of existing real estaterelated taxes. Not surprisingly, these cities have also become advocates of the introduction of the property tax, either locally or nationally.

6. Conclusion

The depiction this report has given of the current state of fiscal federalism in Chinese taxation may perhaps be distilled into the following three themes.

First, the decision-making process about how taxing power is allocated among the central and sub-national governments still lies almost entirely outside the framework of law. This

129. See Reuters, "China may launch environmental tax trial," Aug. 5, 2010; "Four Provinces Hope to Become First Environmental Pilots; Revenue May be Split between Center and Localities," 21st Century Economic Report, Aug. 10, 2010. One of the provinces (Hubei) had already experimented with the collection of existing pollution charges by tax authorities. Id.

130. See "Environmental Tax Pilot Projects Not Expected to Launch with 2010," Economic Observer News, Aug. 6, 2010.

131. "Real Estate Speculation May be Subject to High Tax, Property Tax Brewing," China Securities News, Apr. 23, 2010.

132. See "Shanghai, Chongqing Experimental Plan for Property Tax Not Yet Approved," Caixin, Jul. 8, 2010 (http://economy.caing.com/2010-07-08/100159271.html).

means that the most fundamental structural components of the Chinese tax system are not regulated by statutes or even formal regulations. The "tax sharing" arrangement–both in its revenue allocation aspect and its division of labour between the LTB and STB systems–is a salient case in point. For all shared taxes and local taxes (i.e. all taxes where the central government is not the exclusive claimant to revenue), design features such as the tax base, tax rates, the method of administration and the extent of tax preferences may have substantial impacts on the budgets of sub-national governments, and yet while these design features may be modified within the framework of law, the modification of the revenue allocation and administrative arrangements, under the current system, cannot. Thus the possibility for any reform of the tax law is contingent on either the achievement of consensus through legally unstructured political processes internal to the executive branch (and the Communist Party), or simply the ability of the central government to dominate those processes at a particular point in time. The legislative branch of government, both at the national and sub-national levels, is still weak. The NPC, in particular, continues to acquiesce in the blanket delegation of tax legislative power to the executive branch made a quarter of a century ago. These political configurations explain much of the ambiguities and gaps in the fiscal legal framework described in Section 3.

Secondly, even after having dispensed with representative democracy and legislative deliberation, the government has not been able to settle on a stable allocation of taxing powers, let alone one that comports with theoretical recommendations. As discussed in 4.3., below the provincial level a very diverse range of fiscal arrangements have been made, sometimes in disregard of the central government's recommendation to copy the central-provincial tax sharing system. And as discussed in 5., between the center and the provinces, prominent skirmishes over the control of local tax reductions and preferences are a continuous affair. The central government has adopted a problematic approach for approving variations in local tax policies: such variations must (i) be truly unique so as not to be applicable elsewhere (which is rare), (ii) take place within ranges and dimensions sufficiently limited so as not to be of significance to sub-national political leaders, or (iii) modify and improve existing national policies in such a way as can be generalized across the country. The last criterion virtually ensures that those attempting local innovation will not have the "copyright" to the products of their experiments, and will thus bear only the cost but not reap the competitive rewards of innovation.[133] Meanwhile, the fact that the doctrine that tax legislative power must be centralized has never been given sufficient policy justification is becoming more and more noticeable, as China moves further and further away from the political economy background of the 1994 tax reform. The central government's attempt to tout the doctrine as "the law" rings hollow, because the statutes and regulations that reflect such doctrine are themselves so ambiguous and incomplete, and have hardly been complied with by the State Council itself.[134]

Thirdly, a coherent system of allocating taxing powers in China is difficult to envision at this point, for a number of reasons. To start with, the allocation of spending responsibilities is still largely unclear, and the current extent of devolution of expenditures is in all likeli-

133. See Susan Rose-Ackerman, *Risk Taking and Reelection: Does Federalism Promote Innovation?*, 9 *J. Legal Stud.* 593 (1980).

134. The indefinite prolonging of the delegation of tax legislative power to the State Council, in contradiction to article 11 of the Law on Legislation, is only one example.

hood non-optimal.[135] The existence of a vertical fiscal gap thus does not imply that taxing power should be further decentralized, it may equally mean that expenditure responsibilities should be more centralized. Moreover, the political system tends towards centralization, and presents obstacles to borrowing other countries' arrangements. The fact, for example, that relatively few jurisdictions beneath the provincial level possess even delegated legislative power[136] seem to rule out the imposition of truly local taxes, such as the property taxes adopted by the lowest level of governments in the US, Canada, and Australia. Furthermore, as other scholars have pointed out,[137] if local government officials are not really accountable to their local constituencies for spending and taxing decisions, many of the textbook arguments for decentralization would not apply. What assumptions one should make in the Chinese context about these exogenous factors determining optimal tax assignment is a very difficult question.

In summary, many factual and conceptual issues remain to be clarified before one can arrive at the conclusion that, in its pursuit of economic development in the last three decades, China has developed a "model" for fiscal federalism that is demonstrably superior to certain other models.[138] Instead, what the economic consequences of the fiscal arrangement that has prevailed since 1994 are, and what the directions of future reform are, will probably continue to be debated for a long time to come.

135. See notes 3-5 and the commentaries cited in note 7 above.
136. See text accompanying notes 18-21 above.
137. See, e.g. Roy W. Bahl, "Intergovernmental Fiscal Relations and Local Public Finance: What Is Next on the Reform Agenda?" in Joyce Yanyun Man and Yu-Hung Hong (eds.), China's Local Public Finance in Transition (Lincoln Institute 2010); Richard Bird , "Taxation and Decentralization," Economic Premise, No. 38, November 2010 (World Bank).
138. Compare the facts presented in this report to the discussion in, for example, Hehui Jin, Yingyi Qian and Barry R. Weingast, *"Regional Decentralization and Fiscal Incentives: Federalism, Chinese Style," Journal of Public Economics*, September 2005, 89 (9-10), pp. 1719-1742.