

1980

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Recommended Citation

Paul D. Reynolds, *Doing Business with the People's Republic of China: Tax Considerations*, 14 INT'L L. 49 (1980)

<https://scholar.smu.edu/til/vol14/iss1/7>

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Doing Business with the People's Republic of China: Tax Considerations

Introduction

Consideration of corporate tax liability in the People's Republic of China (PRC) may appear on first impression unnecessary. It might seem reasonable to assume that the PRC is a totally communist society. Taxing industries which are owned by the State or people would therefore be a mere bookkeeping function. Why should the State tax the profits of an enterprise when the profits accrue to the State anyway?¹ This assumption is, in all probability, quite well founded. Such an analysis, however, overlooks the other functions a tax system plays in an economy. Taxation can be used as an anti-inflationary tool by restricting the supply of money, as a societal transformation tool by favoring socialized enterprise over private enterprise, and as an economic planning tool by permitting constant governmental monitoring of industrial spending.² The PRC has had problems with enterprises spending their profits in unauthorized manners or delaying transmission of their profits to central authorities. Collecting taxes regularly and frequently enables authorities to keep the enterprises "in financial difficulties," and therefore makes them more "amenable to financial discipline."³

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¹This attitude prevails even in the PRC. Professor Donnithorne, an English economist, notes the problem of Chinese tax collectors' inefficiency. A reason given is that they "have thought that as profits of state enterprises . . . are in any case going to the state treasury, it is of little importance to make a clear distinction between tax and profits: 'both eat out of the same pot.'" A. DONNITHORNE, *CHINA'S ECONOMIC SYSTEM* 375 (1967) [hereinafter cited as DONNITHORNE]. See also note 62 *infra* for a recent article in the People's Daily.

²For other descriptions of taxation's uses in China, see Perkins, *Industrial Planning and Management*, in *ECONOMIC TRENDS IN COMMUNIST CHINA* 619 (A. Eckstein, et. al., ed. 1968).

³DONNITHORNE, *supra* note 1, at 375.

If a foreign private enterprise, such as an American oil exploration company, forms a joint operation with the PRC state oil company, the PRC's tax rules would no longer be an internal bookkeeping transfer. They would represent a real cost of doing business to the American company. As many American businesses consider establishing operations inside the PRC—whether joint venture, service agreement or banking operations—PRC's system of taxation needs to be considered in overall planning.

Before describing some aspects of this system, those involved in planning such transactions should be cautioned. First, information presently available is fragmentary and incomplete.⁴ Access to more details of the PRC's tax system will be necessary. Even United States Treasury officials accompanying former Secretary Blumenthal on his recent trade mission were unable to obtain much additional information. Second, available information is generally dated. The Korean conflict shut off Western scholars from source materials for over one and a half decades. Additionally, the Chinese appear to have done very little with their system since 1950 and hardly anything since 1958. A United States Treasury official was told in February, 1979 by a Chinese counterpart that "[W]e really haven't thought much about it since 1958."⁵ Third, as with so many aspects of Chinese society and government, the tax system is under review and changes are expected.⁶ Clearly, these remarks must be viewed as tentative and subject to revision.

Having effectively minimized the importance of any contribution this article might hope to make, let me outline its scope. Its primary focus is upon taxes potentially affecting foreign business entities carrying on operations inside the PRC. Companies involved in simple export sales generally need only be concerned with customs duties which can easily be calculated into the sale price. After placing taxation's role in the economy in perspective, the various types of taxes are described. Their rates and application are discussed, and projections are made concerning future changes. Finally, the impact on United States tax liability and possibilities for reduction of United States taxes are outlined.

I. Role of Taxation in the Chinese Economy

A. *Historical Perspective*

The tax system must be viewed in its historical setting. When the Communists came to power they inherited a country which had a good deal of essential and nonessential tasks carried out by private enterprises. The early regime did not attempt to immediately stamp out capitalism and private en-

⁴For example, from 1963 until June 1979 no laws were formally published. Thus difficulties are even encountered in answering a basic question—is there an income tax in China? See notes 60-61 & accompanying text *infra*.

⁵Telephone interview with a United States Department of the Treasury official (May 25, 1979) (permission to cite source not granted).

⁶See Part V *infra*.

terprise. Rather, it started to gradually phase out nonessential free enterprise while taking over essential industries via state enterprises.⁷ Progressive and differential tax rates were used to encourage the socialized enterprises like heavy industry and discourage nonessential capitalistic enterprises.⁸ Redistribution of land and wealth as well as control over inflation were accomplished through leveling an income tax on the "capitalist" income of individuals.⁹

That these pressures were successful in placing revenue producing resources under State control is attested to by the fact that in 1950 less than one third of government revenue was from state enterprises, while in 1959 almost 98% came from the socialized sector.¹⁰ Thus, the dominant role of taxation in generating revenue naturally subsided after the State gained ownership of most resources.¹¹

The relative importance of tax revenue to the overall budgeting revenue of the PRC is demonstrated in the following Table I.

⁷G. ECKLUND, *FINANCING THE CHINESE GOVERNMENT BUDGET, MAINLAND CHINA 1950-1959*, at 22-25, 58 (1966) [hereinafter cited as ECKLUND]. See also A. ECKSTEIN, *CHINA'S ECONOMIC REVOLUTION 50-53* (1977) [hereinafter cited as ECKSTEIN]. A self-criticism of this policy is seen in *REPORT ON THE QUESTIONS REGARDING THE ECONOMIC SITUATION AND THE READJUSTMENT OF INDUSTRY, COMMERCE, AND TAXATION* (June 15, 1950), translated and reproduced in I CHAO KUO-CHUN, *ECONOMIC PLANNING AND ORGANIZATION IN MAINLAND CHINA* 208-213 (1959) [hereinafter cited as CHAO KUO-CHUN].

⁸ECKLUND, *supra* note 7, at 23, 25, 107-08.

⁹Perkins, *Price Stability and Development in Mainland China*, 72 J. POL. ECON. 360, 370 (1964).

¹⁰ECKLUND, *supra* note 7, at 21.

¹¹The effect of government pressures to force direct industry to socialize is seen in the following table. The process of conversion to joint public-private enterprise and state-owned enterprise was gradual yet rapid.

Socialization of Industrial Enterprises
(in percent)

Year	State-Owned	Joint Public-Private	Private but under some government control	Private and free of control
1949	34.7	2.0	7.5	55.8
1951	45.9	4.0	21.4	28.7
1953	57.5	5.7	22.8	14.0
1955	67.7	16.1	13.2	3.0

SOURCE: STATE STATISTICAL BUREAU, *TEN GREAT YEARS* 38 (1960), cited in ECKSTEIN, *supra* note 7, at 76.

Table 1¹²

PRINCIPAL SOURCES OF BUDGET REVENUE,
1950-1959, 1970-1972 (IN PERCENT)

REVENUE SOURCES	1950	1952	1957	1959	1970-1972
Tax Revenue.....	75.1	55.6	49.9	37.8	(36)
Industrial & Commercial Taxes	34.7	35.0	36.4	28.9	(30)
Agricultural Tax	29.2	15.4	10.0	6.0	(6)
State Enterprise Profits	13.3	26.5	36.6	52.7	(60)
All Other Revenue.....	11.6	17.9	13.5	9.5	(4)
	<u>175</u>				
TOTAL.....	100.0	100.0	100.0	100.0	100.0

B. Present Importance

Even though taxation has decreased in importance as a source of governmental revenue—becoming secondary to state enterprise profits—it still constituted almost 35% of budgetary income during the 1970s.¹³ The four major tax sources are: consolidated industrial and commercial taxes,¹⁴ agricultural

¹²Calculated from data in G. ECKLUND, *supra* note 7, Table 1 at 20. Data for 1972 is based on an interview with Fu Tse-hao (December 1972), cited in A. ECKSTEIN, CHINA'S ECONOMIC REVOLUTION 184 (1977).

¹³D. WHITTAKER & P. SHINN, AREA HANDBOOK FOR THE PRC 560 (1972) [hereinafter cited as AREA HANDBOOK].

¹⁴The present Consolidated Industrial and Commercial Taxes are described in Part III *infra*. This law was preceded by a group of taxes: (1) a commodity tax; (2) a commodity circulation tax; (3) an industrial and commercial tax (consisting of two parts—gross receipts tax and income tax); and (4) a stamp duty. Those taxes are also discussed in Part III *infra*. See ECKLUND, *supra* note 7, at 58-71.

¹⁵The agricultural tax is a tax on the yield of land rather than on the value of the land as in the United States. It is collected in kind and stored in government controlled warehouses. It is assessed not on actual yield but on a hypothetical norm established by locally designated committees. The system is not progressive although norms for yields vary among provinces. The governing law of this complex tax was modernized in 1958. See 7 COLLECTED LAWS AND REGULA-

taxes,¹⁵ salt taxes¹⁶ and customs duties.¹⁷ All of these are indirect taxes. The industrial and commercial taxes have retained prominence throughout the Communist rule. The agricultural tax remains a close second, but has diminished in relative importance because of other sources of revenue.¹⁸ The salt taxes and customs receipts continue as a minor but reliable source of revenue with the former contributing from 1 to 3% of total budgetary revenue during 1950-1959 and the latter as much as 5.5% but usually less than 3%.¹⁹ Although the PRC has utilized other taxes as compliments to its financial plans, most notably an income tax on capitalist income, the emphasis in taxation continues to be in the area of indirect consumer taxes.

II. Tax Structures and Sources

A. Administration and Collection

The Ministry of Finance is responsible for preparing and implementing the budget after it has been approved by the National People's Congress. Tax revenues are collected by the Ministry through tax offices at all levels of government.²⁰ These offices are attached to central, provincial and municipal governments. Often, additional tax collectors are permanently stationed at larger production plants.²¹ These tax collectors have several functions. While aiding tax collection, they also introduce and refine accounting systems. On occasion they participate in planning solutions to production and marketing problems by providing financial advice.²²

Many taxes are collected directly and on a regular basis for immediate deposit with the People's Bank.²³ Agricultural taxes, usually paid in kind, are

TIONS OF THE PEOPLE'S REPUBLIC OF CHINA 245-53 (Jan.-June 1958) (in Chinese), summarized in AMERICAN CONSULATE GENERAL (Hong Kong), SURVEY OF CHINA MAINLAND PRESS NO. 1782 (1958); UNITED STATES JOINT PUBLICATIONS RESEARCH SERVICE, TRANSLATIONS IN COMMUNIST CHINA'S ECONOMIC THEORY AND ACCOUNTING SYSTEM (1959). For a general description, see DONNITHORNE, *supra* note 1, at 337-46; ECKLUND, *supra* note 7, at 43-58.

¹⁶A traditionally favored tax because of its inelastic demand and ease of collection, it is a tax on per unit weight of edible salt. Only producers of salt pay tax. No wholesale or retail tax is collected. For further details, see ECKLUND *supra* note 7, at 20, 33, 64-65.

¹⁷Since foreign trade is strictly controlled by the central government import duties are unnecessary for protective or fiscal reasons. The PRC retains duties as a bargaining tool in trade negotiations. See DONNITHORNE, *supra* note 1, at 380. Customs duty accounted for only 1.5% of government revenue in 1955. *Id.* Rates are quite high ranging from 5 to 400%. ECKLUND, *supra* note 7, at 71. See also [1979] INT'L TRADE REP.—EXPORT SHIPPING MANUAL (BNA) § 35.6.

¹⁸ECKSTEIN, *supra* note 7, at 184.

¹⁹ECKLUND, *supra* note 7, at 64 & 71.

²⁰*Id.* at 32-33.

²¹AREA HANDBOOK, *supra* note 13, at 560.

²²ECKLUND, *supra* note 7, at 33-4.

²³*Id.* at 33.

collected at harvest time and stored in government warehouses.²⁴ Salt taxes are administered separately by the General Salt Tax Administration, while customs duties are collected by the General Customs Office of the Ministry of Foreign Trade.²⁵

B. *Types of Taxes*

The main components of the tax system are sales and commodity taxes. During the years 1955-1958 these indirect consumer taxes produced four times the amount of revenue as did direct taxes on income and wealth.²⁶ The decision to emphasize indirect general sales taxes rather than direct income taxes was due, in large part, to developmental considerations.²⁷ It was felt necessary to disguise the heavy consumer tax burden required to produce revenue for industrialization.²⁸ The extent of this burden is shown by the fact that the percentage of consumer money income taken by taxes nearly doubled from 1950-1959, increasing from 17% to approximately 33%.²⁹

The absence of a personal income tax in prerevolutionary China³⁰ helped fuel inflation because profits were placed in speculative investments.³¹ However, the new Communist government felt that a personal income tax would dampen incentives to work.³² The government therefore chose to rely on indirect taxes—mostly sales and turnover taxes—at the production, wholesale and retail levels. These taxes were combined with direct wage controls and “voluntary” savings deposits and bond sales.³³ These measures quickly reduced inflation while providing the government with fiscal revenue to finance new state enterprises.

III. Consolidated Industrial and Commercial Taxes

A. *Predecessors to Consolidated Taxes*

Prior to consolidation in 1958, commercial enterprises were subject to several different taxes, including a gross receipts tax and a net income tax. The receipts tax ranged from 1 to 3% on merchandise sales and 1.5 to 15% on

²⁴AREA HANDBOOK, *supra* note 13, at 560.

²⁵ECKLUND, *supra* note 7, at 33; DONNITHORNE, *supra* note 1, at 380-81.

²⁶ECKLUND, *supra* note 7, at 115.

²⁷Perkins, *Price Stability and Development in Mainland China*, 72 J. POL. ECON. 360, 369 (1964) [hereinafter cited as Perkins].

²⁸*Id.*

²⁹ECKLUND, *supra* note 7, at 110.

³⁰Only certain types of “capitalist” income were subject to the early forms of income tax. There was no general form of personal income tax. Today, individual wages are free of direct taxation, though there have been periodic payroll taxes of 1 to 2% on wages. Interest income was taxed at 5% until the tax was abolished in 1959. See ECKLUND, *supra* note 7, at 75. Further information and sources can be found in DONNITHORNE, *supra* note 1, at 378-380.

³¹ECKSTEIN, *supra* note 7, at 164.

³²ECKLUND, *supra* note 7, at 111-12, 116.

³³Perkins, *supra* note 27, at 370.

services.³⁴ The tax applied to all goods and services, including necessities. The net income tax had progressive rates from 5% up to a maximum of 30%.³⁵ For essential industries the income tax could be reduced 10 to 40% below otherwise applicable rates.³⁶ These discretionary reductions were rescinded in 1957 as no longer essential for economic development.³⁷

Early taxes included two types of commodity taxes and a stamp tax. The first commodity taxes appear to have resembled a manufacturer's excise tax. Rates were differentiated along the same lines as the gross receipts tax with essential products being taxed at the lowest rate. The rates ranged from 3 to 120% of the taxable value of the commodity and were payable by the producer or wholesale buyer.³⁸ The second commodity tax operated like a turnover tax at rates between 7 to 66%.³⁹

Stamp taxes were imposed on all documents used in commercial transactions or transfers of property, except property transfers under the Communist distribution program. Rates were either fixed (on certain types of transactions) or based on a flexible amount (0.01 to 0.3%) of the value of the transaction.⁴⁰

The PRC made some slight changes in commercial and industrial taxes in 1953.⁴¹ The most important changes included lowering the minimum rate under the gross receipts tax to 1.5% and reducing and consolidating the items subject to the commodity taxes.⁴² Despite these efforts the early system was complex and overlapping.

B. The 1958 Consolidation

Government efforts, including the taxes described above, had by 1958 brought about the virtual disappearance of the private sector in the economy. Therefore, four of the taxes described above were reduced and consolidated

³⁴ECKLUND, *supra* note 7, at 60. The text of the 1950 gross receipts tax is reproduced in the Appendix *infra*.

³⁵*Id.* at 61.

³⁶*Id.* The text of the income tax is also reproduced in the Appendix *infra*.

³⁷*Id.* at 62, citing People's Taxation, May 10, 1957.

³⁸ECKLUND, *supra* note 7, at 62-63. The tax was based on the wholesale price of specialized commodities and was payable by producers or wholesale buyers. It was amended in 1953, again in 1958, and replaced by the Consolidated Industrial and Commercial Tax in 1958. See 8 COLLECTED LAWS AND REGULATIONS OF THE PEOPLES REPUBLIC OF CHINA 126-144 (July-Dec., 1958) [hereinafter cited as COLLECTED LAWS].

³⁹This was the commodity circulation tax referred to in note 14 *supra*. Introduced as a sales tax in 1953, it is considered the forerunner of the broader turnover tax, the Consolidated Tax, adopted in 1958. ECKLUND, *supra* note 7, at 66-67. It applied to only 22 products selected for their large volume, concentrated production and degree of state controlled production. For these commodities it superseded the commodities tax, *supra* note 37, the stamp tax, the income tax and the gross receipts tax.

⁴⁰ECKLUND, *supra* note 7, at 63-64. Not all stamp duties were abolished in 1958. See DONNITHORNE *supra* note 1, at 381 and sources cited therein.

⁴¹Described in ECKLUND, *supra* note 7, at 65-67.

⁴²*Id.* at 68.

into a single commodity tax in 1958.⁴³ Only the income tax survived, albeit in a limited form. This new tax is known as the consolidated industrial and commercial tax and is a major tax potentially affecting private business operations carried on by Western companies.⁴⁴ It is imposed on sales proceeds rather than on goods at various stages of processing. It might also be described as a turnover tax. The tax reflects efforts to reduce the complexity of the previous multiple systems and thereby simplify tax administration and collection.⁴⁵ The tax is modeled on the Soviet turnover tax⁴⁶ and applies to a broad range of items including retail farm products, industrial products, retail sales, imports, and services.⁴⁷ Intermediate taxation of products at each stage of production was eliminated so that only sale by the producer and retail sale were taxable.

C. Enterprises Subject to Tax

The consolidated tax must be paid by all enterprises operated for profit within the PRC. These include state, private, joint state-private, and cooperative enterprises.⁴⁸ Manifestly, this would include joint ventures by Western companies with state-owned enterprises.⁴⁹ It would appear to apply to services such as oil and gas exploration.

D. Exempt Enterprises

Certain organizations are exempt from the consolidated industrial and commercial tax. State banks, insurance concerns, agricultural machinery stations, medical and health institutions and scientific research bodies have been granted an exemption through the discretion vested in the Ministry of Finance.⁵⁰ Other exemptions may be granted on a provincial level within specified limits.⁵¹ It is unclear whether a state monopoly such as the national oil company qualifies for such an exemption. It is even less clear that a joint venture, such as one with an American or Japanese company, would be exempted.

⁴³ECKLUND, *supra* note 7, at 25, 67; DONNITHORNE, *supra* note 1, at 373 n.4, 378.

⁴⁴8 COLLECTED LAWS, *supra* note 38, at 126-44, summarized in AMERICAN CONSULATE GENERAL (Hong Kong), CURRENT BACKGROUND No. 527 (Oct. 27, 1958). This law was promulgated in September 1958.

⁴⁵Donnithorne, *Background to the People's Communes*, 32 PAC. AFF. 339, 345 (1959).

⁴⁶For descriptions of the Soviet Union's turnover tax see H. HOLTZMANN, SOVIET TAXATION (1955); A. NOVE, THE SOVIET ECONOMY 104-106 (rev. ed. 1965).

⁴⁷DONNITHORNE, *supra* note 1, at 372.

⁴⁸*Id.* See also 1950 INDUSTRIAL AND COMMERCIAL INCOME TAX LAWS AND REGULATIONS, art. 9 [hereinafter referred to as INCOME TAX LAW], reproduced in the Appendix *infra*.

⁴⁹See INCOME TAX LAW, *supra* note 48, art. 6.

⁵⁰DONNITHORNE, *supra* note 1, at 372-73, citing 8 COLLECTED LAWS, *supra* note 38, at 127-28. It is clear, however, that many state and joint state-private enterprises do pay industrial and commercial taxes. In 1957 state enterprises provided 53% of industrial tax revenue with joint enterprises providing an additional 25%.

⁵¹AREA HANDBOOK, *supra* note 13, at 561.

E. Applicable Rates and Calculation

The consolidated tax is imposed as a percentage of goods or services sold with each commodity taxed only once at the production stage. The retail tax is only imposed if the product reaches that stage of distribution. Taxes are calculated on actual prices received by producers and distributors, not on the official state wholesale prices.⁵²

Tax is assessed as a percentage in three different ways depending on the type of goods or services. Industrial producers, importers of non-agricultural products, and retailers calculate the tax as a percentage of total sales proceeds *including* the tax itself. Importers and purchasers of farm output calculate their tax on a basis of total payments made. Transport, communications and service enterprises calculate tax on “business income”—presumably their total receipts.⁵³ Imported manufactured goods are assessed on a total which includes c.i.f. prices, customs duty and consolidated industrial and commercial tax.

Rates differ according to product or service. In Table II the product tax rate is seen to range from 1.5 to 69%. Table III gives more detailed rates for certain product groups. Within these categories and ranges products or services which are necessities are taxed at very low rates. For example, grain is taxed at 4% of the purchase price while electric power is taxed at 5%.⁵⁴ Note that products or services sold at both the production and retail stages are normally taxed twice. Thus cigarettes are taxed at 69% when produced with an additional 3% at the retail level for an effective tax of 72% on this luxury item.

Table 2⁵⁵

RATES UNDER CONSOLIDATED TAX

<i>Product or Service</i>	<i>Rate</i>
Industrial and Agricultural Products	1.5% (unbleached cotton cloth) 69% (cigarettes)
Retail Sales	3%
Communication and Transportation	2.5% of receipts
Service Trades	3 to 7% of income—(gross?)

⁵²ECKLUND, *supra* note 7, at 69.

⁵³DONNITHORNE, *supra* note 1, at 372.

⁵⁴*Id.* at 360 & 137 n.1.

⁵⁵Calculated from data in ECKLUND, *supra* note 7, at 69; DONNITHORNE, *supra* note 1, at 372.

Table 3⁵⁶

**TAX RATES FOR INDUSTRIAL AND COMMERCIAL PRODUCTS UNDER
THE CONSOLIDATED INDUSTRIAL AND COMMERCIAL
TAX, 1958, PEOPLE'S REPUBLIC OF CHINA**

<i>Commodity</i>	<i>Tax Rate (percent)</i>
Tobacco, wine, and alcohol	20-69
Certain consumer goods (including cosmetics)	6-55
Foodstuffs	2.5-44
Leather, hair, feathers	10-40
Textiles and yarn	1.5-35
Light electrical equipment	11-25
Cement, brick, and timber	5-20
Paper and pulp	3-20
Coal and petroleum products	2-20
Rubber products	10-18
Rolled metal products	11-15
Chemical acids and alkalies	6-12
Metal ores and metallurgical products	5-10
Machines and machinery, and other manufactured goods	5

F. Payment of Tax

Tax is due and payable on the day sales proceeds are received. This normally involves a simple transfer from the seller's account to the local tax office or branch of the People's Bank.⁵⁷ Importers pay taxes at the same time as customs duty. Tax is computed on the basis of c.i.f. charges plus customs duty for industrial imports. Enterprises with well-established accounting systems can simply submit their records to substantiate the amount of tax due. They file their own tax returns subject to a later audit.⁵⁸

G. Penalties for Nonpayment

During its early development, the central government often levied extreme fines on private businesses for purported tax evasion with the ultimate goal of putting them out of business.⁵⁹ A provision existed as recently as 1958 for an

⁵⁶Compiled from CURRENT BACKGROUND, *supra* note 44; ECKLUND, *supra* note 7, at 70.

⁵⁷AREA HANDBOOK, *supra* note 13, at 561.

⁵⁸ECKLUND, *supra* note 7, at 36. The need for a uniform and simplified tax collection system was recognized early on. See CHAO KUO-CHUN, *supra* note 7, at 213. See also Regulations on the Administration of National Taxation (Jan. 31, 1950), *id.* at 226; Report on the Problem of Adjustment of Taxes (June 15, 1950), *id.* at 228.

⁵⁹ECKLUND, *supra* note 7, at 42.

additional tax of 10 to 100% of the liability in cases of unreasonably large capitalist profits. It is unlikely that this regulation is still effective, given the fact that the central government owns virtually all the resources and that the levy's discriminatory features have long outlived their usefulness. However, Professor Donnithorne reported its continued existence in 1967.⁶⁰

Any business that violates the requisite reporting or investigation provisions would be subjected to a penalty of up to 1 million yuan. Those who intentionally falsify records are subject to penalties of 1-10 times the payment. Extreme cases are referred to the People's Court for disposition.⁶¹ In case of overdue industrial and commercial taxes, the Ministry of Finance imposes a uniform fine of half of a percent per day of the overdue balance. These regulations, still partially in force, provide guidance on the Chinese responses to tax evasion.⁶²

H. Impact on Industry Structure

Pomp and Surrey point out that this tax's structure favors vertically integrated firms.⁶³ An industry which is vertically integrated producing its own goods and providing its own services pays less tax than firms that must purchase goods and services from third parties. The act and tax administrators take measures to reduce the resultant tax advantage to integrated firms.⁶⁴

IV. Income Tax

A. Structure and Scope

Despite some recent confusion,⁶⁵ it appears that the 1950 income tax has survived despite the 1958 consolidation of other taxes on industry and com-

⁶⁰DONNITHORNE, *supra* note 1, at 379, citing 7 COLLECTED LAWS, *supra* note 38, at 267.

⁶¹See INCOME TAX LAW, *supra* note 48, art. 24.

⁶²The problem of tax evasion is discussed in ECKLUND, *supra* note 7, at 40-43 and DONNITHORNE, *supra* note 1, at 374-75. Just after the Revolution evasion was widespread and expected. Businessmen could see the end of their private enterprises and tax evasion was one way to recoup more of their investments. The problem still persisted, however, long after private enterprise was defunct. Reports in the official press frequently cited evasion as late as 1962. ECKLUND, *supra* note 7, at 43. A recent article on the People's Daily, June 7, 1979, at 3, recounts the result of investigative reporting. Entitled *The Enterprise Must Pay Tax in Accordance with Law*, it states that many production units, including State enterprises, have failed to pay tax. The reporter cites the attitude of some enterprises that tax is associated with "capitalist hacks" and is an attempt to sabotage socialist enterprises. The reporter exhorts revolutionary councils to strictly enforce tax regulations, and punish violators with fines or "severely, according to law." The author is grateful to Dr. T. Hsia for informing him of this article.

⁶³Pomp and Surrey, *Taxation in the People's Republic of China* (eds. Holtzmann and Surrey) 1979.

⁶⁴Consolidated Industrial and Commercial Tax Regulations, article 6.

⁶⁵Professor Jan C. Ting of Temple University Law School was told by Chinese officials in December 1978 that China had no income tax system. Interview with Jan C. Ting, Professor of Law at Temple University (July 7, 1979). Professor Jerome Cohen of Harvard University reported officials told him there was such a system. 106 FAR EASTERN ECON. REV. 125, 127 (1979). Mr. Emil Sunley, Deputy Assistant Secretary of Treasury for tax policy is quoted in Wall St. J.,

merce.⁶⁶ The basic structure of this tax is believed to be that contained in the 1950 Industrial and Commercial Tax Regulations (reproduced below). The important change has been a reduction in the number and type of taxpayers to the present level where few enterprises pay income tax.

Originally, "all industrial and commercial enterprises operated for profit . . . including public, private, joint public/private, and cooperative enterprises" had to pay taxes.⁶⁷ From the beginning, most state-owned enterprises were exempted or covered under special regulations.⁶⁸ By 1956, virtually all private industrial and commercial enterprises had ceased to exist or had been placed under joint state-private ownership. Dividends paid to former owners were transformed, in 1956, into fixed interest payments. This method of paying private owners still prevails today.⁶⁹ Simultaneously, income tax liability of these joint enterprises was eliminated.⁷⁰

Who remains liable now that state and joint state-private enterprises have been removed from income tax obligations. Professor Cohen believes that this tax is now limited to income of people's communes, collective handicraft

March 2, 1979, p. 8, col. 4, as stating that the Chinese "currently have an income tax of 69 percent on foreign investment." Other experts, like Dr. Tao-Tai Hsia, had no knowledge of a corporate income tax system in China. Interview with Tao-Tai Hsia, Chief of the Far Eastern Law Division of the Library of Congress (June 6, 1979).

⁶⁶ECKLUND, *supra* note 7, states that the new consolidated tax "was promulgated in 1958 to replace the following taxes (which were abolished): (1) the commodity tax, (2) the commodity circulation tax, (3) the gross receipts tax, (4) the net income tax, and (5) the stamp tax." *Id.* at 67. Numbers (3) and (4) are the two taxes contained in the 1950 Regulations, which are reproduced in the Appendix. The gross receipts portion of these Regulations was clearly abolished and replaced by the 1958 consolidation.

The evidence of the income tax's survival is compelling. Professor Donnithorne expressly states that taxes (1), (2), (3), and (5) above were consolidated and replaced while the income tax remained. DONNITHORNE, *supra* note 1, at 373 n.4, 374. Footnote one and the text of the 1950 legislation supplied by China (reprinted in the Appendix, *infra*) only speaks of the turnover tax (same as the gross receipts tax) being incorporated into the 1958 consolidation. Footnote three of the 1950 legislation cites the *surcharges* to the *income tax* authorized by the same standing committee which passed the consolidation. Such a change would be unnecessary if the income tax had been abolished.

⁶⁷INCOME TAX LAW, *supra* note 48, art. 1.

⁶⁸DONNITHORNE, *supra* note 1, at 378.

⁶⁹See e.g., Articles of Association of the Bank of China (rev. 1962), art. 35 (interest of 7 percent per annum to shareholders is stipulated). This is cited in Wilson, *The Bank of China's Expanding Role in International Finance*, 1 U.S. — CHINA BUSINESS REVIEW 21, 26 (1974). More recently the Fujian (Fukien) Provincial Investment Enterprise Company was reestablished with authority to issue stock to overseas Chinese "foreign industrialists and businessmen." Wall St. J., May 30, 1979, at 19, col. 2. Although reports describe the payout as 8% minimum annual "dividends," reference is made to the pre-Cultural Revolution Fujian investment company's "dividends." Since the earlier company paid interest and not dividends it appears likely that this is merely an error in reporting or translation. See DONNITHORNE, *supra* note 1, at 513-14.

⁷⁰DONNITHORNE, *supra* note 1, at 378 n.4. See the 1956 changes in the "New Regulations on Tax Payment by Private Industrial and Commercial Establishments after Transformation" (Aug. 14, 1950) reproduced 1 CHAO KUO-CHUN, *supra* note 7, at 237-39 (1959).

groups and street peddlers.⁷¹ In 1969 Donnithorne, too, wrote that these were the only classes of enterprises subject to the income tax.⁷²

B. Rates and Calculation

Both authorities report the basic rates to be from 5.75% to 34.50%.⁷³ This conforms with the text of the Regulations.⁷⁴ Surcharges were reported in 1958; 10 to 50% on "better-off" individual handicraftsmen and peddlers and 10 to 150% on any remaining capitalist industrialists and merchants.⁷⁵ It is unofficially reported that a general surcharge exists, currently a uniform 60% throughout China.⁷⁶ Any major taxpayer would therefore be subject to an effective current rate of 55.2%.

The tax is a *net* income tax. Article 5 merely states that the "method of handling the part calculated according to income will be settled separately."⁷⁷ Article 18 states that "[i]ncome will be calculated as the amount of gross receipts during the business year or actual period of business remaining after deduction of costs, expenses and losses."⁷⁸ Cohen states that these include production costs, administrative expenses, and "other necessary expenses including the amount of consolidated tax paid."⁷⁹ Depreciation charges could be deducted on the basis of either an average annual sum or a fixed annual percentage, commonly 10% of the initial cost for the former method or 20.6% for ten years under the latter.⁸⁰ It is not known if these deductions are still available at these rates. Taxes must be estimated at the "end of the second quarter of the year; the tax should be paid in full by telegraphic transfer after the year-end balancing of the books," no later than March of the following year.⁸¹

V. Projected Changes

Recent accounts of pending changes in the PRC's commercial and legal rules make it clear that major tax revisions will also be forthcoming.⁸² The

⁷¹106 FAR EASTERN ECON. REV. 125(1979). The number of independent businesses is expected to increase dramatically as the government liberalizes its policies. For an example of this trend see Kramer, *China Authorizes Licensing Peddlers, Other Entrepreneurs*, Wall St. J., Aug. 15, 1979, at 12, col. 2.

⁷²DONNITHORNE, *supra* note 1, at 379.

⁷³See 106 FAR EASTERN ECON. REV. 125, DONNITHORNE, *supra* note 1, at 379.

⁷⁴See the Graded Income Tax Schedule contained at the conclusion of INCOME TAX LAW, *supra* note 48, reproduced in the Appendix *infra*.

⁷⁵7 COLLECTED LAWS, *supra* note 38, at 267. See also INCOME TAX LAW, *supra* note 48, at n.3.

⁷⁶106 FAR EASTERN ECON. REV. 125.

⁷⁷INCOME TAX LAW, *supra* note 48, art. 5.

⁷⁸*Id.* art. 18. ECKLUND, *supra* note 7, at 59 cites the PEOPLE'S PRACTICAL ECONOMIC DICTIONARY (1953) definition of income as "gross sales minus cost of goods sold minus selling expenses, general expenses, and financial expenses plus non-business income minus non-business losses."

⁷⁹106 FAR EASTERN ECON. REV. 125.

⁸⁰*Id.*

⁸¹INCOME TAX LAW, *supra* note 48, art. 21.

⁸²Cohen & McAfee, *China Builds Legal Framework for Modernization*, Nat'l L.J., May 21, 1979, at 30, col. 1.

PRC's desire to host joint venture operations with foreign partners will require restructuring. New tax methods will also be needed to deal with production sharing, compensation trade and construction contracts.

A. Models for the PRC

Assuming PRC tax laws will be changed, what direction will these changes take? Are there indications of what the PRC's corporate tax system will be like in 1981?

In the past, the PRC's legal and tax system has been heavily influenced by the Soviet Union. That influence has waned. In its stead, the PRC has been closely studying other foreign models—in particular Rumania and Yugoslavia.⁸³ These countries are among the Communist nations which have permitted Western business to join in joint ventures with state enterprises.

B. Some Examples in Other Communist Countries

The following sketches of East European tax systems for joint ventures may be a valid guide to future Chinese developments:

1. YUGOSLAVIA

Joint ventures were first permitted in 1967. The foreign partner in a joint venture is permitted to sell or transfer its interest and is allowed to remit its entire share of the profits subject to withholding taxes. Net profits are ordinarily subject to tax at 35% with provisions for various exemptions.⁸⁴

2. RUMANIA

Joint ventures were first permitted in 1971. Foreign ownership of up to 49% is permitted, subject to registration with the Ministry of Foreign Trade. Repatriation of profits and capital is guaranteed by the State so long as taxes and social security dues have been paid. Taxes are set at 30% for joint enterprises. A reserve fund of 5% of profits is also required to a maximum accumulation of 25% of invested capital. This fund counts as a deduction from gross income. Tax reductions and exemptions are provided in various instances, including reduction to 10% if a portion of capital is reinvested. Dividends are subject to a 10% withholding tax if transferred out of Rumania.⁸⁵

3. HUNGARY

Hungary first permitted joint ventures in 1970. Joint enterprises may be established with the agreement of the Minister of Finance provided foreign participation does not exceed 49%. An income tax of 40% on net profits is

⁸³*Id.*

⁸⁴P. JONAS, *TAXATION OF MULTINATIONALS IN COMMUNIST COUNTRIES* 13-19 (1978).

⁸⁵*Id.* at 13, 20-21.

levied after deductions for a risk fund and shareholders' fund. If profits exceed 20% of capital, the tax rate on the excess is 60%.⁸⁶

The Council for Mutual Economic Assistance (CMEA or COMECON), guidelines currently call for taxation of foreign joint ventures at between 30–40% of net profits. Reductions are to be made up to a 0% tax on profits from capital reinvested.⁸⁷

C. Recent Chinese Law on Joint Ventures

In July 1979, the People's Congress approved new legislation on joint ventures.⁸⁸ Containing only fifteen articles, the new legislation is but a broad regulatory framework dealing with permissible percentages of foreign ownership, pro rata board representation and protection of the foreign partner's right to repatriate profits. The new legislation does not address several tax questions: Will the present income tax be reduced or waived for foreign investors and joint ventures? Will joint ventures be exempted from the consolidated industrial and commercial tax? If exemptions are not granted will a tax holiday be provided? What withholding taxes will be applied to interest and dividends repatriated by the foreign investor?

The new legislation guarantees the right of foreign countries to remit profits abroad in foreign currencies. The law does provide for a full or partial rebate of income taxes. The tax rates are not yet established but rebates will be available during the first two or three years the joint venture makes a profit—in effect a “tax holiday.” Further rebates will be available if profits are reinvested by the foreign participants.

Joint ventures may be established with the permission of the Foreign Investment Control Commission, only recently established. Foreign ownership will generally be limited to 49% but must be at least 25%. In some cases ownership of 100% may be permitted, but presumably a large portion of such shareholding will be without voting rights. In all cases the joint venture will have a chairman appointed by the PRC.

VI. Impact on United States Tax Liability

PRC taxation is almost entirely indirect. The present net income tax has minimal application. For companies which carry on business in or with the PRC, taxes will generally arise only on specific transactions inside or upon entry to the People's Republic. There is no indication of any Chinese attempt to levy a tax on business transacted outside the PRC by non-Chinese compa-

⁸⁶*Id.* at 21–22; Lorinczi & Dorian, *United States – Hungarian Joint Ventures: Prospects and Problems*, 10 L. & POL'Y INT'L BUS. 1205 (1978).

⁸⁷JONAS, *supra* note 84, at 23.

⁸⁸Ching, *Foreign Partners in Ventures with China Offered Package of Incentives, Protection*, Wall St. J., July 9, 1979, at 6, col. 1. Material in this section is largely drawn from this article and from two previous articles by Mr. Ching. See generally, Wall St. J., June 13, 1979, at 16, col. 2; Wall St. J., June 27, 1979 at 10, col. 2.

nies. Given the limited scope of Chinese taxation, what are its impacts on the United States tax liability of American companies doing business with the PRC? The possibility of tax credits, deductions and exemptions must be considered.

A. Foreign Tax Credits: Direct and Indirect

A direct tax credit against United States tax is allowed on any foreign income taxes paid directly by a United States taxpayer on income from foreign sources provided that certain provisions of the Internal Revenue Code (IRC) are met.⁸⁹ Foreign source income under section 862(a)(6) includes income from the sale of personal property outside the United States that was originally purchased within the United States.⁹⁰ For example, electronic components sold to the PRC by a United States company with title passing upon arrival in Shanghai would normally generate foreign source income. Similarly, income from services rendered outside the United States is also considered income from foreign sources.⁹¹ Income taxes paid on such foreign income may create a credit against United States taxes.

An indirect tax credit is available to a United States shareholder having at least a 10% interest in the company which paid foreign income taxes. A section 902 credit, however, can be claimed only if the subsidiary declares a dividend.

B. Availability of Credit

Under present law, only the 1950 income tax imposed by the PRC qualifies as an "income tax" against which a United States tax credit would be available. However, section 903 provides for a foreign tax credit in cases where the foreign tax is paid "in lieu of" income or other qualifying taxes.⁹² Given the history and structure of the PRC tax system, a strong case can be made that the consolidated commercial and industry tax is a gross turnover tax adopted for reasons of ease of administration and in lieu of a net income tax. There is a clear history of gradual replacement of income taxes by indirect taxes. Provision exists for a ruling by the Commissioner that certain taxes are "in lieu of income taxes." Companies seeking to do business with the PRC, directly or indirectly, would do well to seek such a ruling. However, the Commissioner has adopted a restrictive attitude toward granting such favorable rulings.

In the absence of a favorable ruling, a definitive congressional amendment might be sought. Congress could bring some of the PRC taxes within the scope of the credit.

⁸⁹ I.R.C. §§ 901, 904, 862(a) or 863 (1976).

⁹⁰ Duffy, *Tax Aspects of Trade With the Republic of China and the People's Republic of China*, N.Y.U. 30th INST. ON FED. TAX 1507, 1509 (1972) [hereinafter cited as Duffy].

⁹¹ *Id.* See generally, Note, *United States Taxation of Trade with China: Problems and Alternatives*, 8 VAND. J. TRANSNAT'L L. 189(1974) [hereinafter cited as Note].

⁹² Note, *supra* note 89, at 201.

C. Deduction

Taxes paid on sales or operations in the PRC would be a business expense. At the very least a business deduction from gross income would be available before United States tax liability was determined.

D. Domestic International Sales Company (DISC)

DISC benefits are available to sales subsidiaries established for the purpose of export sales. To obtain DISC benefits, highly complex tax rules must be met. These include the requirement that 95% of the DISC's receipts must be qualified export receipts.⁹³ DISC benefits are designed for the shareholders and the company itself. The principal advantage is that DISC profits are free from current taxation and may sometimes be reinvested tax free.⁹⁴

Such a tax structure would be truly advantageous only for companies involved in sales to the PRC. Firms carrying on operations or providing services inside the PRC should ordinarily look to other provisions of the Code for tax benefits.

E. China Trade Corporations

Under terms of the China Trade Act,⁹⁵ special corporations could be organized under United States law whose principal place of business was China. Such corporations were allowed special tax credits.⁹⁶ However, the definition of "China" in the act never included the People's Republic of China.⁹⁷ The act was repealed in 1976.⁹⁸

F. Tax Treaties

There is no tax treaty at the present time with the PRC. However, both the United States and the PRC are contemplating such a treaty and seem disposed toward one. A treaty would be one method of resolving some of the problems (described above) caused by the fundamental difference between the two countries' systems.

Potential treaty benefits are:

1. conflicting or inconsistent IRC sections would be superseded by such a treaty;⁹⁹

⁹³1.R.C. §§ 991-97. See also 1 R. RHOADES, INCOME TAXATION OF FOREIGN RELATED TRANSACTIONS § 441[2] (1979); W. STRENG, INTERNATIONAL BUSINESS TRANSACTIONS — TAX AND LEGAL HANDBOOK § 7.03 (1978).

⁹⁴Feinschreiber, *DISC: A New Export Tax Incentive*, 40 FINANCIAL EXECUTIVE 66 (1972)

⁹⁵The China Trade Act, ch. 346, 42 Stat. 849 (1922).

⁹⁶Duffy, *supra* note 90, at 1509-10.

⁹⁷As originally enacted, "China" included Manchuria, Tibet, Hong Kong and Macao. In 1954 the definition was changed to include only Formosa and Hong Kong. 1.R.C. §§ 941-43.

⁹⁸1.R.C. §§ 941-943 were repealed in Pub. L. No. 94-455, title X, § 1053(c), 90 Stat. 1649 (1976).

⁹⁹1.R.C. §§ 894, 7852(d).

2. tax benefits or solutions peculiar to Sino-American trade could be established separately without affecting provisions relating to other countries;
3. alleviation of the need for either the United States or the PRC to alter trade or tax practices in order to do business; and
4. relative ease in implementing a treaty compared to congressional amendment of the Code.¹⁰⁰

From 1949 to 1967 the PRC has concluded no double taxation treaties and only a handful of customs tariff reduction agreements.¹⁰¹ However, attitudes of the present leadership are quite different.

VII. Conclusions

The system of taxation in the People's Republic of China is in line with those encountered in other Communist countries. It has been stable if somewhat unimaginative. What changes have occurred reflect efforts at simplification or changes in the structure of Chinese society.

Western businesses should assume that taxation in the PRC is of relatively minor impact in their business dealings. However, changes should be expected and agreement on applicable rates should be sought. Preferably such agreement should expressly override subsequent general changes in taxation. Express exemption from the 1950 income tax should be sought. If a joint venture is established special income and withholding tax provisions will soon be effective. Reduction of the rate or a tax holiday should be negotiated. Given the PRC's need for foreign investment there is every reason to expect a flexible attitude in these negotiations.

¹⁰⁰Note, *supra* note 91, at 204.

¹⁰¹A check in D. JOHNSTON & H. CHIU, *AGREEMENTS OF THE PEOPLE'S REPUBLIC OF CHINA 1949-1967*, A CALENDAR (1968) provides information only through 1967.

Appendix

The following legislation was the major tax on industry and commerce from 1950 until 1958 when the Consolidated Industrial and Commercial Tax was enacted. The two taxes established in this 1950 law were often officially referred to as a "business tax." The structure of this law is not clear on first reading. The tax has two parts, only one of which is a net income tax. The second part, a gross receipts tax, was consolidated and superseded by the above mentioned 1958 Act. The income tax provisions remain in effect although the classes of taxpayers have been greatly reduced.

The following is an unofficial translation supplied through the courtesy of the United States Department of the Treasury.

Industrial and Commercial Income Tax Laws and Regulations

Temporary Industrial and Commercial Tax Regulations:

(Approved at the 17th Conference on Government Affairs of the Government Administration Council, January 27, 1950; promulgated on January 30 by the Government Administration Council, revised and approved at the 63rd Conference on Government Affairs of the Government Administration Council, December 15, 1950; promulgated by the Government Administration Council on December 19, 1950.)

Chapter One: General Principles

ARTICLE ONE: All industrial and commercial enterprises operated for profit within the borders of this country, including public, private, joint public/private, and cooperative enterprises, except for those governed by other regulations, will, according to the provisions of these regulations, pay industrial and commercial taxes at the place where their business is transacted.

ARTICLE TWO: Industrial and commercial enterprises are categorized according to type of operation as permanent industrial and commercial enterprises, temporary industrial and commercial enterprises, and peddling.

ARTICLE THREE: Taxes that should be paid by permanent industrial and commercial enterprises include an amount calculated upon total turnover (hereafter called turnover tax) and an amount calculated according to the amount of income (hereafter called the income tax). (Footnote one)

ARTICLE FOUR: Methods of accounting and levying taxes of temporary commercial and peddling enterprises will be decided separately by the Ministry of Finance of the Central People's Government.

ARTICLE FIVE: The part of the industrial and commercial tax calculated according to turnover payable by publicly operated enterprises will be paid at the place of business; the method of handling the part calculated according to income will be settled separately; no income tax will be paid on retained profits.

ARTICLE SIX: Joint public/private industrial and commercial enterprises will pay taxes in the same way as ordinary industrial and commercial enterprises.

Footnote One: Industrial and commercial taxes include turnover and income taxes. The turnover tax levy was incorporated in the industrial and commercial consolidated tax levy in 1958.

ARTICLE SEVEN: The industrial and commercial taxes which should be paid by cooperative enterprises will be considered for reduction or exclusion in accordance with the provisions of the cooperatives law. The methods by which the cooperatives will pay taxes will be decided separately.

ARTICLE EIGHT: Exemption from industrial and commercial taxes is granted to:

- 1) state selling and manufacturing monopoly enterprises;
- 2) poor artisans and cottage industry;
- 3) others who have been approved by the Ministry of Finance of the Central People's Government.

Chapter Two: Tax Rates

ARTICLE NINE: Industrial and commercial taxes will be calculated according to the following tax rates:

- 1) differentiated turnover tax calculation;
 - A) for those calculating according to gross receipts from business, the tax rate is 1 percent to 3 percent;
 - B) for those calculating according to gross earnings the tax rate is 1.5 to 6 percent;
 - C) for those calculating according to earnings on commissions, the tax rate is 6 to 15 percent; the turnover tax schedule with differentiations based on type of operation is (omitted).
- 2) the income tax is calculated progressively on total income; the tax rate is 5 to 30 percent. (Footnote two) (Footnote three).

The differentiated income tax schedule follows.

ARTICLE TEN: The amount of income tax calculated according to section two of Article Nine above will, according to the needs of the country's economic construction, be reduced 10 to 40 percent, depending upon the type of operation, as a material incentive. (Footnote four)

The schedule providing the range of enterprises eligible for income tax reductions is (omitted).

Footnote Two: In the 1950 "Announcement concerning some tax system revisions and implementation periods" by the finance and economic committee of the Government Administration Council, it was stipulated that "the income tax and local surtaxes should be levied together." After combination, the income tax rate will be 5.75 to 34.5 percent.

Footnote Three: The "regulations concerning the improvement of the tax management system" adopted at the 75th meeting of the plenary session of the State Council on April 11, 1958 and approved at the 17th meeting of the standing committee of the National People's Congress on June 5, 1958, stipulate, *inter alia*: an additional levy of 10 to 100 percent may be imposed on the amount of income tax due from capitalist businessmen and peddlers. This limit may be exceeded for those who have obtained especially large profits.

Footnote Four: As resolved by the 47th meeting of the State Council, 1957: Article 10 in the temporary regulations on industrial and commercial taxes promulgated by the Government Administration Council in 1950, stipulating that the income tax on some enterprises may be reduced from 10 to 40 percent in accordance with the requirements of national economic construction, is nullified and rescinded as of the 1957 annual income tax assessment.

Graded Income Tax Schedule

Grade Level	Income Differentials	Tax Rate (Percent)
1	Annual income under 300 yuan	5.75
2	Annual income Y300-400	6.90
3	" " Y400-500	8.05
4	" " Y500-600	9.20
5	" " Y600-700	10.35
6	" " Y700-800	11.50
7	" " Y800-900	12.65
8	" " Y900-1000	13.80
9	" " Y1000-1100	14.95
10	" " Y1100-1200	16.10
11	" " Y1200-1300	17.25
12	" " Y1300-1400	18.40
13	" " Y1400-1500	19.55
14	" " Y1500-1700	20.70
15	" " Y1700-2000	21.85
16	" " Y2000-2500	23.00
17	" " Y2500-3500	25.30
18	" " Y3500-5000	27.60
19	" " Y5000-7500	29.90
20	" " Y7500-10,000	32.20
21	" " Y10,000 and above	34.50

ARTICLE ELEVEN: Industrial and commercial units that are classed together in terms of operations but which are unable to use a single turnover tax rate, should calculate their tax obligation as follows:

- 1) where two or more types of operations are carried on, the tax obligations should be calculated for each according to the relevant tax rate; where it is difficult to differentiate between the operations, the highest rate should be used to calculate the tax.

- 2) those for whom it is difficult to differentiate an industrial or commercial character should calculate the tax according to the commercial tax rate.
- 3) those continuous production industries producing several types of products with different tax rates should calculate the tax obligation according to the lowest tax rate.

Chapter Three: Reports and Investigations

ARTICLE TWELVE: Industrial and commercial enterprises, prior to commencement of operations, conversion to another type of operation, or cessation of operations should, in addition to registering with industrial and commercial management organs according to the regulations and taking out or returning for cancellation a business report, also submit copies to the tax affairs offices for reference.

ARTICLE THIRTEEN: Industrial and commercial enterprises should at the prescribed times submit figures for total turnover and income, completed reports and other schedules required for inspection to the tax affairs organs for their review.

ARTICLE FOURTEEN: Industrial and commercial enterprises should establish as their principal books a daily ledger and a cumulative ledger; they should also issue and collect receipts in the course of their business activities.

ARTICLE FIFTEEN: In order to understand the operations and financial conditions of industrial and commercial enterprises, the tax affairs organs will carry on scheduled general inspections and unannounced investigations. Industrial and commercial enterprises should base reports on actual conditions and are not permitted to conceal anything or to refuse to cooperate.

ARTICLE SIXTEEN: Personnel dispatched by the tax affairs offices to carry out official duties should produce their office's papers for verification. Industrial and commercial enterprises should refuse to provide accounts and certificates to persons without papers and should report to tax affairs offices for their investigation.

Chapter Four: Calculation and Payment

ARTICLE SEVENTEEN: Calculation of the amount of turnover is stipulated as follows:

- 1) gross business income is calculated as the net value of product sales which is the value of gross sales less sales discounts and product returns.
- 2) gross business earnings are calculated as remunerations, handling fees, remittance fees, interest, insurance fees and other earnings. No reduction of any costs or expenses is permitted; however, fees for insurance which accrue to sub-insurers should be deducted from total insurance fees of insurance companies.
- 3) earnings from commissions will be calculated as the entire amount of such earnings; no deductions of any costs or expenditures will be permitted.

ARTICLE EIGHTEEN: Income will be calculated as the amount of gross receipts during the business year or actual period of business remaining after deduction of costs, expenses and losses.

ARTICLE NINETEEN: Industrial and commercial enterprises should distribute dividends only after calculating their tax obligation.

ARTICLE TWENTY: Assessment of the industrial and commercial tax will be undertaken by the tax affairs offices in the localities after due consideration of actual conditions by the following methods:

- 1) those enterprises with well-established accounting systems whose assets and tax obligations can be verified, after review and approval by the tax affairs offices, may report and audit their own accounts and, according to the tax rates, calculate their own tax assessments according to total turnover and total income.
- 2) those who do not meet the standards set in the preceding paragraph must combine the practice of submitting materials for public discussion and democratic evaluation with their own inspection of the materials in calculating the tax assessment according to the tax rates.
- 3) relatively small enterprises should, on the basis of democratic discussion, employ the practice of setting specific amounts and specific time periods in calculating their tax assessment.

ARTICLE TWENTY ONE: The turnover tax will be paid monthly and quarterly; those paying quarterly should complete payments during the months of April, July, October and January. An estimate of the income tax should be made at the end of the second quarter of the year; the tax should be paid in full by telegraphic transfer after the year-end balancing of the books. Complete settlement must be made no later than March of the following year. (Footnote five)

ARTICLE TWENTY TWO: In the event of a cessation of operation because of reorganization, merger, dissolution, transfer or insolvency, or at the time of an announcement of liquidation, industrial and commercial enterprises must report and pay turnover taxes and income taxes due for the period of operation within a prescribed time limit.

ARTICLE TWENTY THREE: The discussions referred to in Article 20 paragraph two of these regulations should be carried out by a democratic discussion committee which should be organized for this purpose.

General guidelines on the organization of the democratic discussion committees will be stipulated separately.

Chapter Five: Penalties

ARTICLE TWENTY FOUR: Whomsoever should violate the provisions of Article 12, Article 13, Article 14, Article 15 or Article 22 of these regulations will pay a penalty of not more than one million yuan. (Footnote six)

ARTICLE TWENTY FIVE: Those who conceal the actual values of turnover or income, in addition to being required to pay the amount of tax that was due, will be fined an amount 1 to 10 times the amount of tax underpayment. Those who falsify evidence or resist or refuse to pay taxes and for whom the seriousness of the cases warrant it, will be handed over to the People's court for disposition.

ARTICLE TWENTY SIX: All persons are equally obligated to expose actions violating the provisions and regulations of the two preceding articles. After investigation and settlement of the case 20 to 30 percent of the fine will be given to the informer as a reward.

ARTICLE TWENTY SEVEN: Those who do not remit taxes within the prescribed time limits, in addition to having to pay within a specified time, will be fined an overdue fine

Footnote Five: As stipulated in the 1956 financial dispatch No. 19 by the Fifth and Eighth offices of the State Council (March 1956); "Income taxes should henceforth be remitted quarterly."

Footnote Six: The one million yuan is stated in the old currency. This converts to 100 yuan of the new currency.

of 1 percent of the amount of tax due each day. When necessary this can be increased or reduced by order of the Ministry of Finance of the Central People's Government. (Footnote seven)

Chapter Six: Supplementary Regulations

ARTICLE TWENTY EIGHT: Detailed rules on the implementation of these regulations will be prescribed separately by the Ministry of Finance of the Central People's Government.

ARTICLE TWENTY NINE: These regulations will enter force on the date of promulgation.

Footnote Seven: The August 15, 1952 Ministry of Finance (52) Finance Tax Notice No. 594 stipulates: the overdue fine rate applying to all industrial and commercial taxes is uniformly reduced to .5 percent.