In early September 1980, the National People's Congress of the People's Republic of China (PRC) approved what may be considered the most innovative step in that nation's new economic policy. This most recent addition is a system of personal income taxation, unprecedented in Chinese history. Until recently, Chinese economic law has not existed in a form recognizable to Western capitalistic societies. Following the fall of the "Gang of Four" in 1976, the focus of the leadership's attention in the "drive to legalization" of their society was the implementation of a criminal code. The abuse of individuals by arbitrary governmental action, prevalent in former administrations, was to be abolished. Currently, the overriding concern of the new leadership, under the auspices of Deng Xiaopeng, is the creation of a more "orderly environment." The influx of foreign trade and investment in recent years has created chaos in the largely unregulated field of economics, and has prompted legislation to insure greater order. The scope of this economic legislation has been reflected in the expanded bases of taxation in China. Following a brief discussion of the other extant forms of taxation in the PRC, this piece analyzes recent developments in the area of personal income taxation.

By 1979, experts noted at least nine true taxes in existence within China. The first is an agricultural tax, established in its present form in 1958. The tax attempts to redistribute land and to increase production. Unlike agriculture taxes in the West, the Chinese tax is not imposed on land value. Instead, the tax is based on the harvest of an average farming year, the "set yield," and is computed by committees of the local governmental unit. The tax rate is then applied to the base to exact tax liability. The tax base may remain the same for years, thus providing an incentive for farmers to increase output while their set yield remains at a lower level of taxation. In the early 1950s, in a push for reduced cost of

---

1 Li, Reflections on the Current Drive Toward Greater Legalization in China, 10 GA. J. INT'L & COMP. L. 227 (1980).
4 Id. at 4 n.9.
6 Id. at 46.
administration, families were urged to join cooperatives, and by 1956 all but three percent of Chinese families had joined. In 1958, the cooperatives were merged into communes. The agriculture tax was designed to be paid by subdivisions of these communes, entitled “Production Brigades.” The only individuals subjected to payment of the tax were commune members who owned private land, or farmers who had not joined communes. Often included under the title “agriculture tax” are several minor taxes, such as the fishery tax, the tax on rural sideline production, and the pastoral tax.

A second type of tax, levied on salt producers, is one of the more stable sources of revenue for the PRC. Its simplistic administration requires a levy on tonnage, with the amount varying between 100 and 160 yuan per ton, depending on the region. Although levied on producers, the burden eventually is shifted through the retail market to the consumer. The salt companies owned by the government, along with some private producers, bear the task of equalizing supply and demand through the adjustment of market prices. Thus, the government could control production and distribution, although the salt tax itself has never been used to tamper with the salt market.

A third type of tax, the slaughter tax, requires levy at the time of slaughter. The tax base is set by weight of the animal and by state retail prices. Upon payment, the taxpayer is exempt from other business taxes because the slaughter tax constitutes part of the industrial and commercial taxes. The percentage set by law differs for slaughter of animals bought from other provinces by state enterprises and for slaughter by other entities, such as communes or schools. If the sale is within the province, the province sets the tax rate. There is no tax on slaughter for home consumption.

By permission of the Ministry of Finance, a real estate tax levied at the city level is also imposed. The amount of the tax
RECENT DEVELOPMENTS

varies for different cities, and is a reliable source of local revenue. Landowners are taxed at approximately 1.2% of the historically-based value of the land. Since almost all land is owned by the state, the transfer of revenue is from the state to the cities. Another city-oriented tax is imposed on vehicle licensing. Paid once a year, the revenues support the building and improvement of roads. Theoretically, the tax applies to all vehicles, although some cities exclude nonmotorized vehicles. The scale for motorized vehicles can be based on tonnage or on a fixed amount. Because most motorized vehicles are not owned by individuals and many nonmotorized vehicles are exempt, the tax cannot be considered as a personal one. In addition, a road tax, the purposes of which are maintenance and improvement of the highway system, is levied on animal-drawn vehicles and motor vehicles not included in the categories exempted.

A sixth category of taxation is customs duties. A broad base of exemptions excludes from the tax all raw materials imported for use in assembly or processing, as well as for additional parts, equipment, or materials. Export duties were abolished in 1959. Historically, customs duties on imports have been used to balance price discrepancies between high-priced domestic goods and inexpensive imports. The tax has been retained for bargaining power in trade negotiations with foreign nations, and as a source of revenue for the central government.

The seventh recognized tax stems from the Industrial and Commercial Income Tax Act (ICITA). Aside from the exemption of most state enterprises, from which profits are returned to the state automatically, all industrial and commercial enterprises within the People’s Republic of China that realize a profit are taxed under ICITA. The Ministry of Finance classifies the industries into one of three categories: permanent, temporary, or street peddlers, and each is taxed accordingly. However, no individual is subject to this income tax. The Ministry of Finance has the power to effec-
tuate different methods of taxation for temporary commercial enterprises and street peddlers, but the only entities actually taxed are collectives and cooperatives. Low-income craftsmen are exempt, and other individuals are not subject to the tax if unable to produce substantial business activity.26

The eighth form of taxation is a result of the Consolidated Industrial and Commercial Tax Act (CICTA).27 Passed in 1958 to replace several independent taxes and to simplify the system,28 this tax is the largest source of revenue for the PRC.29 The procedure used resembles what is commonly referred to as a turnover tax. At each transfer of services or goods in the various stages of production and sale, tax can be imposed.30 The tax cannot be levied, however, on products that are developed and used by an industry for its own purposes of production.31 An enterprise that produces goods for non-production purposes or for capital construction is taxed on those products.32 This system is viewed favorably by the present government because it provides an incentive to increase revenue. Since the tax is imposed without regard to whether the business is making a profit, owners will necessarily need to produce more in order to ensure that a profit remains after the tax.33

The ninth tax, levied on foreign shipping, is viewed as an alternative to the Industrial and Commercial Income Tax and the Consolidated Industrial and Commercial Tax. It is levied on income from two sources, freight that originates in China and freight and passengers that are loaded in China. The total rate is a little more than three percent, comprised of a three percent base rate with an optional local levy of .03 percent.34 In addition to the existing tax systems, described as incentives, the Chinese permit

26 Id. at 6.
27 Id. at 12. More than 100 types of agricultural and industrial products are taxable under CICTA, at rates from 1.5% to 69%. Id. at 17-18.
28 G. ECKLUND, supra note 5, at 67. Replaced were: 1) the commodity tax, 2) the commodity circulation tax, 3) the net income tax, 4) the gross receipts tax, and 5) the stamp tax.
29 A. DONNITHORNE, supra note 8, at 372.
30 Pomp & Surrey, supra note 3, at 15.
31 A. DONNITHORNE, supra note 8, at 373. The exceptions to this rule are leather, hides, spirits, and cotton yarn.
32 Id. at 374.
33 Id. at 5 n.13. Ecklund recognizes, in addition to the nine major tax categories, a few relatively inconsequential taxes and fees collected by local governments, such as an amusement tax, judicial fees, funeral fees, registration and inspection fees, and some survey and construction fees. G. ECKLUND, supra note 5, at 77.
licensing on a limited basis of small shopkeepers, urban peddlers, door to door salesmen, and repairmen. Whether the licensees are subject to the provisions of ICITA depends upon whether they are considered a substantial commercial enterprise.

In the years since 1976, the plan for modernization in China has focused on four general areas: defense, technology, industry, and agriculture. Full scale modernization of an economy with the goal of improving standards of living usually necessitates foreign currency to pay for imports required. During the past few years, the problem posed by the lack of Chinese-held foreign currency was circumscribed to some extent by the use of compensation trade. This arrangement focuses on processing and assembly facilities. For example, foreign firms export capital equipment to China. In return, the Chinese pay in installments with goods produced by the equipment, thereby attaining capital imports without exporting foreign currency.

In 1979, the Fifth National People's Congress linked incentives for the modernization of technology, trade, and investment with the promulgation of the new joint venture law. The July 8, 1979 enactment of the joint venture law provided guidelines for the mutual participation of foreign and Chinese investors in profit-making enterprises. Maher gives the following characterization of the basic law involved:

The fifteen article law, while not as specific as some Western businessmen had hoped it would be, offers guidelines under which management procedures and procedures for the employment and discharge of staff and workers can be stipulated in detail in the contract or articles of association of the joint venture, gives legal protection for a foreign partner's assets and profits, and provides general principles for the organization and operation of joint ventures.

Article seven of the 1979 joint venture law states:

The net profit of a joint venture shall be distributed between the parties to the venture in proportion to their respective shares in the registered capital after the payment of a joint venture income tax on its gross profit pursuant to the tax laws of

35 Wall Street J. Aug. 15, 1979, at 12, col. 3.
37 Id. at 12.
the People's Republic of China and after the deductions therefrom as stipulated in the articles of association of the venture for the reserve funds for the workers and staff members and the expansion funds of the venture. . . . 33

This method for determination of net profits is unsatisfactory because it fails to specify whether the deductions required from the gross profit are to come before or after the income tax is levied. 39 Perhaps article two of the joint venture law, as revised in 1980, will solve this dilemma. As its language explains: "The taxable income of a joint venture shall be the net income in a tax year after deduction of costs, expenses, and losses in that year." 40

As is apparent from the foregoing synopsis of taxation in the People's Republic of China, as of September 1980, no system for taxation of personal income existed, although an individual income tax was proposed in 1950. 41 Indeed, in 1964 Premier Chou En-lai stated that the current government had never implemented a personal income tax. 42 Although the government purportedly had levied a tax on income from profits, an unexpected level of administrative difficulties prevented the yield of much revenue. 43 The major sources of income for individuals are wages, pensions, or interest from savings accounts. Since personal income sources were not gained from commercial enterprise, they were not taxable under any of the tax schemes existing prior to September 1980. 44 Although the Chinese government once imposed a tax on interest, it was abolished in 1959. The interest rate paid by the People's Bank was correspondingly reduced to counter the loss of tax revenue. 45

In view of the fact that the 1980 session of the National People's
Congress recognized a governmental deficit of eleven billion dollars for 1979 (due in part to compensation of officials deprived of jobs during the cultural revolution; farm subsidies; benefits to workers; and higher wages), the new personal income tax system is a vital part of the overall economic plans, the perceived goals of which are to "safeguard Chinese economic interests." A preliminary question, which will receive critical analysis in the economic sphere, is why an income tax. In the theoretical battle over the most efficient method of personal taxation, comparisons between the two competing systems, expenditure and income, are based on an imaginary society without tax. It would seem that the pre-September 1980 China would have provided the perfect setting for the development of the ideal system. Nevertheless, income rather than expenditure was chosen for subjection to taxation.

Modern proponents of an expenditure tax, following the lead of John Stuart Mill, argue that taxation of savings allowed in the present system presents a case of double taxation. For example, people are induced by payment of interest to save rather than to consume. Interest, as a compensation for delayed gratification (a return on the accumulation), is not a real increase; any tax levied on it may arguably be termed a second tax on the earnings. In refuting this stance, Professor Gunn of Cornell University suggests that the psychological cost of deferred opportunities cannot be taken into account under either system. The double tax argument would allow cost of lost opportunity to be deducted by savers but not by spenders who incur similar costs. Edwin R.A. Seligman bases his objection to the double taxation argument on two factors. First, he points to an apparent misunderstanding of the fact that receipt and disposition of income are distinct functions, with both spending and saving falling into the latter category. Thus, "the concept of income is independent of the use to which it is put." Second, the first year's tax is imposed on the income, while the second year's tax is a new one, increased due to the added income. They are, it is asserted, successive taxes on different incomes which augment ability to pay, and not simply one

50 Seligman, Income Tax, in 7 Encyclopedia of the Social Sciences 626, 630 (1932).
double tax.\textsuperscript{51} The Chinese may have avoided argument on this issue by including in their list of nine exemptions from taxation the interest on savings deposits in Chinese banks and credit cooperatives.\textsuperscript{52}

In defense of an expenditure tax, it is posited by one commentator that if the primary motive of a revenue-raising tax is to curtail consumption of economic resources in order to free them for redistribution to the poor, then the burden should be distributed progressively in relation to levels of consumption, without taxing accumulation, \textit{i.e.}, consumption already curtailed.\textsuperscript{53} If the aim is taxation of the stock of wealth itself, it may be assumed that those who have more spend more, and thus a consumption tax along with a higher tax directed at massive accumulations of wealth (\textit{e.g.}, taxation at death or intergenerational transfer) also protects those who need to save.\textsuperscript{54}

Gunn states that the taxation of expenditures ignores the basic premise that taxes should be tied to the taxpayers' ability to pay. An expenditure tax would allow those with accumulated wealth to live frugally and avoid taxes, whereas it would tax heavily those who either prefer or are forced to spend their earnings.\textsuperscript{55} Perhaps this analysis, in conjunction with the communist-socialist-Maoist philosophy of the PRC, explains the choice of an income tax system. The current average monthly salary in China is between sixty and eighty yuan ($41-$54),\textsuperscript{56} an amount difficult to tax in any form. With development of the economy, however, more residents will enter higher income brackets, and according to communist principles of equality, they must contribute more to the State.\textsuperscript{57}

\textsuperscript{51} Id. at 630-31.


\textsuperscript{53} Andrews, supra note 48, at 1165-66.

\textsuperscript{54} Id. at 1171-72.

\textsuperscript{55} Gunn, supra note 49, at 379. See also E. SELIGMAN, THE INCOME TAX HISTORY, THEORY AND PRACTICE OF INCOME TAXATION (2d ed. 1914). Seligman traces this latter fault to the nineteenth century overthrow of excise and expenditure taxes under the auspices of democratic revolution. Id. at 10-11. Although unjustified as a sole basis of taxation, Seligman finds that the expenditure tax is useful "either where income cannot be ascertained or where, because of the temporary character of the individual's sojourn, a property or income tax could not be well enforced." Id. at 17. On the issue of the regressiveness of the expenditure tax, Andrews states that it is a personal tax "with graduated rates and personal exemptions that can be adjusted to whatever levels are thought to be appropriate." Andrews, supra note 48, at 1174.

\textsuperscript{56} TIME, Sept. 15, 1980, at 55.

\textsuperscript{57} [1980] P.R.C NATIONAL AFFAIRS L15 (Sept. 3, 1980) (0W040017 Beijing XINHUA Domestic Service in Chinese 0351 GMT) [hereinafter cited as P.R.C. NATIONAL AFFAIRS].
The Individual Income Tax Law of the PRC provides for an individual income tax on anyone whose monthly wage or salary is over 800 yuan ($545). The tax is levied on the portion of income that exceeds the 800 yuan level. This fixed rate deduction of 800 yuan covers cost of living and necessary expenses of the wage earner and dependents. A lump-sum deduction simplifies administration and avoids a major drawback of the expenditure tax. In an expenditure system, although taxation of businesses might be simplified by making all capital expenditures immediately deductible, complexity would have to be accounted for, and large and non-recurring personal expenditures would have to be capitalized and depreciated. Although the relative number of Chinese citizens currently affected is very low, increases are expected. In fact, the major focus of the tax will be on the increasing number of foreign personnel earning income in China.

The Chinese base the need for taxation of income on two considerations. First, an income tax adheres to the principle of mutual benefit. This principle seeks reciprocity for the increasing number of Chinese nationals abroad who pay an income tax to foreign governments. The second consideration emphasizes the need to safeguard China's economic interests, and therefore requires the choice of income taxation as opposed to expenditure taxation. Money earned in the People's Republic will not necessarily be reinvested there, although incentives in the new tax plan are designed to encourage such a result. China is neither a major exporter nor a major producer; therefore, money earned in the country is often spent elsewhere. Spending outside Chinese borders would circumvent an expenditure tax, and would preclude the opportunity to gain foreign currency by tax on the income of foreign nationals whose salaries are paid in their own currency. The scope of China's income tax is determined with reference to two classes of individuals. Any individual residing in the PRC for a year or more is taxed on income earned inside or outside China. Nonresidents or persons residing in China for less than one year are taxed only on income earned in China.
The tax law lists six categories of taxable income, including 1) wages and salaries; 2) compensation for personal services; 3) royalties; 4) interest, dividends, and bonuses; and 5) income from the lease of property. The presently limited sources of income led to the formulation of this seemingly exclusive list; however, the drafters added an escape clause for future economic development. This additional clause, constituting a sixth category, allows the Chinese Ministry of Finance to specify other kinds of income as taxable. Nine categories of exempted personal income are listed, including interest on savings deposits.

The stipulated rates of taxation fall into three categories. The first refers to income from wages and salaries. Progressive rates from five to forty-five percent are levied monthly on incomes in excess of the specified deduction amount. It is noteworthy that

<table>
<thead>
<tr>
<th>Grade</th>
<th>Range of Income</th>
<th>Tax Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Monthly Income of 800 yuan and less</td>
<td>exempt</td>
</tr>
<tr>
<td>2</td>
<td>That part of monthly income from 801 yuan to 1,500 yuan</td>
<td>5</td>
</tr>
<tr>
<td>3</td>
<td>That part of monthly income from 1,501 yuan to 3,000 yuan</td>
<td>10</td>
</tr>
<tr>
<td>4</td>
<td>That part of monthly income from 3,001 yuan to 6,000 yuan</td>
<td>20</td>
</tr>
<tr>
<td>5</td>
<td>That part of monthly income from 6,001 yuan to 9,000 yuan</td>
<td>30</td>
</tr>
<tr>
<td>6</td>
<td>That part of monthly income from 9,001 yuan to 12,000 yuan</td>
<td>40</td>
</tr>
</tbody>
</table>

*Id.* art. 2.

*Id.* art. 4. These categories are:

1) Prizes and awards for scientific, technological or cultural achievements;
2) Interest on savings deposits in the state banks and credit cooperatives of the People's Republic of China;
3) Welfare benefits, survivors' pensions and relief payments;
4) Insurance indemnities;
5) Military severance pay, decommission or demobilization pay for cadres and fighters of the armed forces;
6) Severance pay or retirement pay for cadres, staff members, and workers;
7) Salaries of diplomatic officials of foreign embassies and consulates in China;
8) Tax-free incomes as stipulated in international conventions to which China is a party or as stipulated in agreements China has signed; and
9) Incomes approved as tax-free by the Ministry of Finance of the People's Republic of China.

*Id.* art. 5. Income is computed in terms of Renminbi (R.M.B.). In foreign currency, income is assessed according to the exchange rate quoted by the State General Administration of the Foreign Exchange Control of the P.R.C., and is to be taxed in R.M.B. *Id.* art. 8.

*Id.* arts. 3 & 5. The chart below illustrates individual income tax rates applicable to wages and salaries.
this rate is lower than those imposed in the United States, France, Japan, Indonesia, and Malaysia. The second category provides that income from compensation for personal services, lease of property, or royalties will be allowed a deduction of 800 yuan for expenses, if the amount in a single payment is less than 4000 yuan. If the single payment is more than 4000 yuan, a twenty percent deduction is allowed. The post-deduction balance is then taxed. The third section of article five of the Individual Income Tax Law provides that interest, bonuses, and dividends ("or other kinds of income") are taxed on the full amount received in each payment. In considering the administration of the tax, Gu Ming, deputy director of the Legislative Affairs Commission of the National People's Congress Standing Committee, explained that the Chinese seek to adopt a measure of taxation "by controlling the sources of income." The responsibility for payment of the individual income tax is on the income earner. The withholding agent is designated as the paying unit. If, however, the taxpayer is not covered by withholding, he is required to file a declaration of income and pay the tax himself.

Taxes are paid to the state treasury, and the tax return is to be submitted to the tax authority within the first seven days of the following month. If the taxpayer earns income outside the PRC, the tax is to be paid and the return submitted within thirty days of the end of each year. A commission of one percent of the amount of tax withheld is paid to the withholding agent.

Legislative enforcement provisions are contained in articles nine, eleven, and twelve. Although the tax authority is given the right to investigate payments, the taxpayer or withholding agent

<table>
<thead>
<tr>
<th>Grade</th>
<th>Range of Income</th>
<th>Tax Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>7</td>
<td>That part of monthly income above 12,000 yuan</td>
<td>45</td>
</tr>
</tbody>
</table>

Id. at appendix.

70 P.R.C. NATIONAL AFFAIRS, supra note 57, at L16.
71 1980 INDIVIDUAL INCOME TAX LAW, supra note 52, at art. 5.
72 Id.
73 P.R.C. NATIONAL AFFAIRS, supra note 57, at L16.
74 1980 INDIVIDUAL INCOME TAX LAW, supra note 52, at art. 6.
75 Id. art. 7. According to article 11, if payment is not made within the prescribed time limits, the tax authority is to set a new time limit and surcharge overdue payments at one-half percent of the overdue tax for every day in arrears, beginning with the first day of default. Id. art. 11.
76 Id. art. 10.
77 Article eleven deals with late payments.
is required to report accurately and provide all relevant information. Refusal to give information or concealment of facts is prohibited. The tax authority, at its discretion, may penalize those who violate the stated requirements, and it may exact back taxes from those who have concealed income or refused to pay. The penalty is based on the seriousness of the offense, but may not exceed five times the amount underpaid or not paid at all. Gross violations are prosecuted in the local people’s courts.

The procedural avenues for dispute settlement are narrow. Unlike the United States system, which provides an alternative, the taxpayer or withholding agent in the PRC who disagrees with the tax authority must pay taxes according to the relevant regulations before he may apply to higher tax authorities for reconsideration. If the decision of the higher tax authority is unacceptable to the taxpayer, the dispute may then be taken before the local people’s court.

Although meager in comparison with the voluminous quantity of tax law generated by Western industrialized nations, the centrally-controlled system of taxation of the PRC has in the past been focused on the most productive forces of the economy, those in the agricultural sector. The current rapid industrialization produced a concomitant need for expansion of the legal framework to ensure stability and continued progress, both economically and philosophically.

The stability and acceptability of personal income taxation is uncertain. Indeed, obedience to this unprecedented body of legislation by the people, the leadership, and the Communist Party may be difficult to ensure. The expanded scope of legislation and growth of confidence in legal entities may depoliticize obedience, or may prove that allegiance to the law and to the party is possible.

It may be maintained that the imposition of individual income tax presages the ascension of capitalism over the heretofore insuperable barriers of communism. On the other hand, it may be asserted that the tax is consistent with the communist philosophy that all profits in excess of needs be returned to the state.

---

78 1980 INDIVIDUAL INCOME TAX LAW, supra note 52, at art. 9.
79 Id. art. 12.
80 Id. art. 13. Article fourteen provides that rules of implementation are to be formulated by the Ministry of Finance. Id. art. 14. Article fifteen provides that the law enter into force at its promulgation. Id. art. 15.
81 Tao-tai Hsia, supra note 2, at 122.
Perhaps the tax is the most feasible and economical plan to provide the resources necessary for a burgeoning society. Furthermore, it may be the best plan for redistribution of wealth and for attaining the equality fundamental to the political structure and ideals of Chinese society.

The loosely-worded structure of the provisions present substantial questions for future interpretation. The consistency with communist economic ideals reflected in future rulings will depend in part upon the continued progress of industrialization balanced with the retention of control by the government. Recurrent upheavals render predictions unfruitful. The basis of the current situation is, however, amenable to delineation. There is presently in existence an individual income tax in the People's Republic of China, which must be complied with by foreign investors and nationals alike. The law is enforced by the Ministry of Finance, and its terms will be the subject of future questions, interpretations, and change.

Olive Elizabeth Bell