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An Introduction to Tax Incentives to Investment in the People's Republic of China

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INTRODUCTION

China's recent emphasis upon achieving modernization has prompted a continued effort to import "up-to-date technology." Such "technology" would include management techniques and labor training, as well as advanced equipment and machinery.

There are several ways in which the importation of technology can be achieved. One method would call for purchasing the desired technology from other nations. Another method would be to establish enterprises with those who possess the technology and learn the technology from them through cooperation in the enterprise. This second method also offers the

1 The P.R.C. is in the process of developing its economy, military, and standard of living. For example, the 1979 Economic Plan emphasizes "the steady progress of the four modernizations." Qiuli, Arrangements for the 1979 National Economic Plan, BEIJING REV., July 20, 1979, at 7.

2 See, e.g., Article 5 of the Joint Ventures Act, which states: "The technology or equipment contributed by any Foreign Participant as an investment shall be truly advanced and appropriate to China's needs. In cases of losses caused by deception through the intentional provision of outdated equipment or technology, compensation shall be paid for the losses."
possibility that the host country could acquire technology by contracting to take over the assets and operation of the joint enterprise after the contract has expired and the foreign partner has made a certain profit from the venture. Both parties would be willing to enter into an arrangement like this because the foreign investor would have made a profit on his investment and the host country would have acquired the technology it sought, as well as the capital equipment necessary for industrial expansion.

Both of the methods referred to above are being used by the P.R.C. today. In fact, both methods are being promoted by the newly instituted tax system in the P.R.C. The tax revenues collected by the tax system allow the P.R.C. to use the first method and buy directly. Tax incentives serve to use the alternate method of attracting enterprises to China so the P.R.C. may learn from them. This article focuses on the inducement to foreign investment offered by the Chinese tax system.

To see how the tax system attracts investment it is necessary to adequately define what a tax incentive is. The term "tax incentives" as used here means financial inducements made through the tax system. Tax incentives may be seen as additional interest or return on investments encouraged by the government, which are provided by exempting or reducing taxes on income that would otherwise be collected. With tax incentives the government foregoes tax revenues it would otherwise have collected in order to induce investment. One example of a tax incentive used in the P.R.C. is a reduction of the tax rate. If a tax rate is reduced the tax owed by an investor to the P.R.C. will decrease proportionally. His after-tax income is therefore greater than it would have been without the tax incentive. Thus, if the tax the investor must pay is lowered, he would be more likely to invest in the host country.

3 In China this is known as a "contractual joint venture."

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In general, tax incentives may be offered through domestic laws, individual contracts between the government and the foreign investor, and through tax treaties with other countries. This article will look primarily at domestic laws and individual agreements since there are no tax treaties covering enterprises at this time.

By instituting tax incentives the P.R.C. has struck a balance between potential tax revenues and the investments which the tax incentives will attract. The balance was struck through the development of a new tax designed to deal with foreign investment in the form of joint ventures using Chinese and foreign capital. This new tax has had to work in conjunction with the pre-existing taxes in China. It will be seen later in this study how, in some cases, the old taxes may have to bend in order to allow the new taxes to attract foreign investment and joint participation in capital ventures.4

Since 1950 the P.R.C. has had a tax system primarily designed to facilitate the collection of revenues from domestic private enterprises. The system also allowed the P.R.C. to exercise a modicum of control over private and collective enterprises in China.5 This system was "inward looking" in that it was oriented toward the domestic needs of the nation at the time the P.R.C. was formed. Presumably, it did not contemplate foreign investment in China, since it made no special provision for foreign investment in the P.R.C.

Since the death of Mao, there has been a basic policy change toward an "outward looking" position. In short, the

4 In particular, we will see how the Consolidated Industrial & Commercial Income Tax's jurisdiction is limited to permit the Joint Ventures Income Tax to have sole jurisdiction over joint ventures with Chinese and foreign capital.

5 Some of this control is suggested in the following articles: Reynolds, Doing Business with the People's Republic of China: Tax Considerations, 14 INT'L LAWYER 49 (1980); Ting, Preliminary Notes on Taxation in the People's Republic of China, 5 REV. SOCIALIST L. 347 (1979), 1 B.C. THIRD WORLD L. J. 71 (1980).
Chinese are encouraging foreign investment and participation. As previously noted, this shift appears to spring from their desire to import "up-to-date" technology. To enable foreigners to enter and deal with China on terms familiar to foreigners, certain domestic laws have had to be changed in order to conform to international commercial standards and expectations.

Accordingly, the Ministry of Finance obtained advice from foreign tax specialists on possible ways of restructuring their tax system. This was a difficult task since they wished to keep their domestic-oriented tax system in place. As a result, new tax laws have had to work with and around the old tax laws. In the development of the new tax laws, confusion arose as to the way in which the new taxes would operate, both independently from, and in conjunction with the old domestic laws of the P.R.C.

This article will attempt to penetrate the confusion that has arisen around the Chinese tax laws by providing an overview of the tax laws and concomitant "tax incentives."

In Part 1 of this article, the division between national and local taxes is described in order to point out the different levels of control and taxation: one on the national, and one on the local (or provincial) level. Each level serves a different function with respect to investment in China. National taxes and incentives influence decisions to invest in the P.R.C. as a whole. Local taxes influence decisions as to where in China (which province) an investor will invest or establish a business.

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7 The P.R.C., as would any country, sought to keep its domestic tax system in place in order to keep an orderly system running rather than disrupting business with the creation of an entirely new network of taxes. The domestic system had served the objectives the P.R.C. sought in a manner which suited their society.
Part I will examine the national sales and income taxes that are applicable to Chinese ventures. From there I will discuss the income taxes applicable to the joint ventures form of foreign investment. In Part II the tax incentive effects of the latter taxes will be discussed in further detail.

Part I TAXES IN THE PEOPLE'S REPUBLIC OF CHINA

Developing countries have taxed enterprises on (1) capital formation, (2) existence, and (3) termination or amalgamation. China has chosen to tax only the existence of enterprises. No initial "capital formation" tax exists. There is not even a fee for incorporation. With regard to liquidation, the only requirements are that all debts are satisfied and that registration of termination is made with the General Administrative Bureau for Industry and Commerce of the People's Republic of China.

Taxes on the existence of enterprises exist at both the national and local levels. Local tax rates are usually a set

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Taxes on capital formation may include taxes imposed upon the registration or recording of legal documents. Id.

Taxes on existence may include income taxes, property taxes, and sales taxes (such as the turnover taxes). Id.

Taxes on termination of an enterprise are usually taxes on the "gain of final results of carrying on business." Id. In most cases these "gains" are from the sale of "capital assets" which were not taxed during the "existence" of the enterprise.

Taxes on "amalgamation" are taxes on the merger or consolidation of enterprises. For tax purposes, some countries treat the amalgamation as if the enterprises were terminated. The gain from the termination would be taxed. Other countries do not treat amalgamation this way for tax purposes. Id.

For an excellent discussion of these concepts I would recommend XIII INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW, Ch. 11, at 11-13.

9 See the appropriate provision in the Joint Ventures Incomes Tax Law, art. 11.
percentage of the national tax payments. In most cases the local government has control over the local rates, within limits specified by the national government.

A basic understanding of the national and local tax systems will be necessary to recognize and understand the tax incentives in effect in China today. There are two types of taxes on enterprise existence that are used in the P.R.C.: income taxes and sales taxes. These two types of taxes, which exist at both the national and local level, are discussed below.

A. NATIONAL TAXES

The national taxes are separate and autonomous taxes which interact to form a network of sales and income taxes. The national sales tax applies to all enterprises in China. In addition, a foreign or domestic enterprise in China will be subject to an income tax. If it is a domestic Chinese enterprise, it will be subject to the Consolidated Industrial and Commercial Income Tax. If it is a joint venture with foreign investment it will probably be subject to the Joint Ventures Income Tax and not the Consolidated Income Tax. It is from and within these tax structures that the tax incentives which we will discuss a little later on are derived and must function. As we will see, difficulties seem to arise in the interaction of these separate tax structures. For instance, one may ask whether the Joint Ventures Income Tax replaces the Consolidated Income Tax as the income tax applicable to the enterprise, or whether it is imposed in addition to that tax. Although the Joint Ventures Income Tax law itself does not speak to these questions, it seems more reasonable that it should replace the Consolidated Income Tax as the income tax applicable to joint ventures. These issues will be examined in greater detail later in this study.
1. National Sales Taxes

China has one sales tax controlled by the national government, the Consolidated Industrial & Commercial Tax (hereinafter cited as the CICT). The CICT is of central importance in any consideration of tax incentives because it is one of the heaviest tax burdens faced by an enterprise in China. The CICT is a "cascading" or "turnover" tax, which means it is collected each time an item in production is transferred from one person or enterprise to another.\(^\text{10}\) In addition, the CICT is a "cumulative turnover tax."\(^\text{11}\) This means that the total tax burden of the CICT is the sum of all CICT tax paid at each transfer. "No [tax] credit is provided for any tax previously paid on the purchase of goods or services."\(^\text{12}\) The tax rates of the CICT range from 1.5% for necessities, to 69% for luxuries.\(^\text{13}\) But the effective overall rates under the CICT are actually much heavier than the aforementioned rates would indicate since the rate is applied again on each transfer. Because of this effect the CICT accounts for over three-fourths of China's total revenues.\(^\text{14}\)

The CICT may be thought of as a tax collected on each


\[\text{11}\] For an excellent discussion of "cumulative turnover taxes" and their effects on businesses, see XIII INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW, Ch. 11, at 11-12 et seq. This source also suggests an alternative form of turnover tax which avoids the oppressive "cumulative" effects. The alternative is known as the Value Added Tax (V.A.T. or T.V.A.). The V.A.T. is a "multistage tax that is imposed at all or at several stages in the manufacturing and distribution process (and also on services rendered)." Id. at 22. It is distinguishable from the "cumulative" tax in that "[t]ax paid at one stage, . . . , is creditable against tax payable at a subsequent stage." Id. at 22.

\[\text{12}\] Pomp & Surrey, supra note 6, at 356. INTERNATIONAL BUREAU OF FISCAL DOCUMENTATION, TAXES AND INVESTMENT IN ASIAN AND THE PACIFIC (2d ed. 1979) [hereinafter cited as TAXES AND INVESTMENT].

\[\text{13}\] TAXES AND INVESTMENT, supra note 12.

\[\text{14}\] Gelatt, supra note 10, at 14.
transfer of an unfinished item in production from one production level with one firm or enterprise, to the next stage of production with another enterprise. Eventually, the finished item is sold to the retailer or to the consumer. This process encourages an enterprise to vertically integrate the various stages of production in order to avoid the CICT tax since no transfer outside the enterprise would occur in that case until the final sale to the retailer or consumer. This effect may be unintended and may be subject to change since China now desires to develop smaller specialized production units over larger all-encompassing ones, and production of commercial goods over capital construction.

2. National Income Taxes

The national income taxes of the P.R.C. may be broken down into three categories. In one category is the tax concerning individuals. The second category contains the commercial income tax applicable to domestic Chinese enterprises the Consolidated Industrial and Commercial Income Tax (hereinafter cited as the CICIT). The third category contains the tax applicable to joint ventures with Chinese and foreign investment, the Joint Ventures Income Tax. This last tax deserves particular attention because it is was grafted onto the old tax system (represented by the CICIT), and may

15 Vertical integration of a business is where all stages of production of an item are contained within one business entity. No transfers among the stages of production outside the business entity is required and therefore none will be taxed by the CICT. Relative to products which have had to be transferred from one stage of production in one business entity to another step in production of another business entity, the products of a business entity with vertical integration possesses a distinct competitive advantage from practical exemption from the CICT.

16 Pomp & Surrey, supra note 6.


18 See Qiuli, supra note 17, at 12.
entirely replace that tax, with respect to "joint ventures."  

a. The Individual Income Tax

China's more recent tax laws contain the first individual income tax in its history. Individual income taxes may affect companies in China because they affect those companies' employees. Any reduction in the tax liability of the employees means the company need not pay more to employees to guarantee a certain after-tax income.

The Joint Ventures Act, article 11, provides that foreign individuals may be taxed on their income from "wages, salaries, or other legitimate sources of income." The more recent Individual Income Tax Law taxes personal income over 800 Yuan (US$546) per month on all income. For non-residents or individuals residing in China less than one year, they shall only be taxed on income gained within China. After that period, all income accruing within or outside China may be taxed at rates up to 45%. Progressive rates from 5 to 45 percent apply to wages and salaries. A flat 20% rate applies

19 In China the term joint venture seems to mean the partnership between Chinese and foreign investors to establish a certain type of enterprise. For these purposes the Chinese investors are branches of the government.

20 Individual Income Tax Law, art. 5. Bonavia, A Rubber Stamp for Stability, FAR EASTERN ECON. REV., September 5, 1980, at 11. It has been noted that this limit will probably exempt all citizens of the PRC. See Loong, China leaves some grey areas, FAR EASTERN ECON. REV., Sept. 26 - Oct. 2, 1980, at 108.

Plainly, such high monthly earnings would be more likely to characterize foreign investors and wage earners in the PRC. Contra, see Wallace, China's New Leap Forward: Free Enterprise, U.S. NEWS & WORLD REPORT, Mar. 23, 1981, at 56, 58, where they quote the exemption limit at $58. This seems consistent with the fact that the Individual Income Tax was preceded by and alluded to in the Joint Ventures Act, the act that specifically dealt with foreign investors and investment in China.

The new rate of conversion is 1.6 RMB to US $1. This means the 800 RMB limit is now comparable to US $500. Note that the Yuan is also called Renmenbi (RMB). Conversation with Chancellory of the People's Republic of China and conversation with the National Council on U.S. -- China Trade, both on March 27, 1981.

21 Individual Income Tax, article 3, § 1.

22 Id. and its appended Tax Rate Chart.
to income from "royalties, personal services, interest, dividends, bonuses and lease of property, and other kinds of income." It has been said that the Individual Income Tax will be unenforceable because if enforced "it will lead to a monstrous loss of goodwill among foreign residents, who already consider themselves taxed enough."  

b. The Consolidated Industrial & Commercial Income Tax

A second type of national income tax in the P.R.C. is that dealing with the existence of commercial enterprises. The oldest of these taxes is the Consolidated Industrial & Commercial Income Tax. (It is separate and distinct from the CICT, which is a sales tax.) The CICIT is the P.R.C.'s general enterprise income tax. It was adopted in 1950 and continues to be applied today.

The national tax rates of the CICIT range from 5.75% to 34.5%. The rates are applied progressively on "income". "Income", in this context, is defined as the "amount of gross receipts" during the business year or actual period of business remaining after deduction of costs, expenses, and losses." Surrey and Pomp have noted that these deductions include "all costs of production, including the consolidated [CICT] tax, administrative expenses, and all other necessary expenses...." Paul Reynolds has observed that depreciation

23 Id. art. 3, § 2.
24 Bonavia, supra note 18.
25 Pomp & Surrey use the term "gross income" in place of "gross receipts." Pomp & Surrey, supra note 6. Others have said that the tax base is the change in "net worth." TAXES AND INVESTMENT, supra note 12, at C.2.1.4.1., at 77.
27 Pomp & Surrey, supra note 6, at 369.
on a straight line method fixed by the government is also permitted as a deduction from "gross receipts." Notably, Surrey and others have stated that there is no separate capital gains tax. Dispositions of "capital assets" such as "hidden reserves" are included as gains or losses of ordinary income.

### c. The Joint Ventures Income Tax

While the CICIT is an income tax on domestic enterprises, prior to 1979 the P.R.C. did not have a special income tax for foreign investment. In August of 1980, the P.R.C. adopted the **INCOME TAX LAW OF THE PEOPLE'S REPUBLIC OF CHINA CONCERNING JOINT VENTURES WITH CHINESE AND FOREIGN INVESTMENT** (hereinafter cited as the JVIT) to govern foreign investment through joint ventures. By using a separate law the P.R.C. has been able to offer a set of provisions that offer tax incentives for foreign investment without conflicting with the functioning of the domestic income tax system.

The development of a foreign venture income tax has passed through three stages. In chronological order, these are (1) the **LAW OF THE PEOPLE'S REPUBLIC OF CHINA ON JOINT VENTURES USING CHINESE AND FOREIGN INVESTMENT** (hereinafter cited as the JVA); (2) the JVIT; and (3) the **DETAILED RULES AND REGULATIONS FOR THE IMPLEMENTATION OF THE INCOME TAX LAW OF THE PEOPLE'S REPUBLIC OF CHINA CONCERNING JOINT VENTURES WITH CHINESE AND FOREIGN INVESTMENT** (hereinafter cited as the Detailed Rules and Regulations of the JVIT). These laws contain the tax incentives (discussed in Part II) specifically designed to attract foreign investment.

In designing the JVIT the P.R.C. had to work with and around the concepts of pre-existing domestic tax laws. These earlier tax concepts had to be manipulated and refined in

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28 Reynolds, supra note 5, at 61.

29 Pomp & Surrey, supra note 6, at 368; TAXES AND INVESTMENT, supra note 6, at C.2.1.4.1., at 77.
developing the JVIT. One such concept to be juggled was the concept of taxable income. This concept shall act as the common thread integrating the following discussion of the three stages of the development of China's new foreign venture tax laws.

The first of the laws dealing with foreign investment is the Joint Ventures Act, enacted by the National People's Congress in 1979. The JVA is a general statement of principles concerning joint ventures with foreign investment in China. It announces a shift in policy from one of isolationism to one of encouraging foreign investment in China. Article 1 of the JVA states:

With a view to expanding international economic cooperation and technological exchange, the People's Republic of China permits foreign companies, enterprises, or other economic entities or individuals ... to incorporate themselves, within the territory of the [P.R.C.], into joint ventures with Chinese companies, enterprises or other economic entities ... on the principle of equality and mutual benefit and subject to authorization by the Chinese government.

The JVA also announces the P.R.C.'s desire to import foreign technology through cooperation in business enterprises. Article 5 of the JVA states:

The technology or equipment contributed by any Foreign Participant as investment shall be truly advanced and appropriate to China's needs. In cases of losses caused by deception through the intentional provision of outdated equipment or technology, compensation shall be paid for the losses.

30 The definition of what is meant by taxable income is important in determining the amount of tax payable and the effective rate of taxation as compared with other countries. The lower taxable income is, the lower the tax payable, and the lower the effective tax rate will be. Taxable income will vary depending on what is included, excluded, and deducted from gross income to arrive at taxable income. In the joint ventures laws the term taxable income has been defined differently in each law. It was first defined as "gross profits," and later as "net income." The difference in definition may be explained as part of the development of the income tax applicable to joint ventures. This process is explored below.
In addition, the Joint Ventures Act seems to envision a way of using the P.R.C.'s domestic tax system to encourage foreign investment and the use of new technology. Reductions, exemptions and restitution of income taxes are mentioned in the Act as rewards for such behavior. 31

Article 7 of this act makes it clear that the P.R.C. will tax enterprises with foreign investment on income earned in China. It stated that joint ventures will be taxed on their "gross profits". The term "gross profits" is officially defined as:

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\text{[Gross Sales] minus [all expenses during production (e.g. -- wages, production costs, & depreciation)]} \\
\quad \text{minus [Commercial & Industrial taxes [the CICT]].}
\]

"Gross profits" were probably chosen as the tax base because they are easier to compute and administer. This is a common reason why less developed countries which do not have the tax bureaucracy to implement more complex techniques, tend to use "gross income" as the tax base.

The Joint Ventures Act also makes clear that a lesser rate of taxation will apply to those enterprises equipped with up-to-date technology. Article 7 of the JVA states, in part, "[a] joint venture equipped with up-to-date technology by world standards may apply for a reduction of or exemption from income tax for the first two or three profit making year."

The Joint Ventures Income Tax (JVIT) was adopted by the National People's Congress in August of 1980. It is based upon the policy statements contained in the Joint Ventures Act, and provides additional detail on the special taxes joint ventures would be subject to. 33

31 Art. 7 of the Joint Ventures Act.
33 Whereas the CICT and CICIT are general taxes and may apply to all enterprises in China, the JVIT, while coexistent with these other taxes, is applicable only to those enterprises which are joint ventures.
Under the Joint Ventures Income Tax, joint ventures will as a rule be taxed at an overall rate of 33%. Different (presumably lower) rates apply to joint ventures "exploiting petroleum, natural gas, and other resources" of China.\textsuperscript{34}

The tax base is defined in the JVIT as the "net income of a joint venture in a tax year after deduction of costs, expenses and losses in that year."\textsuperscript{35}

This definition of taxable income appears to be a change from the "gross profits" tax base mentioned in the Joint Ventures Act. The change may be seen as part of the development of the income tax for joint ventures. The P.R.C. may have used the term "gross profits" in the JVA for want of a better term, or as a provisional term to be used until they could decide more definitely what they wanted to include in the tax base for joint ventures.\textsuperscript{36} This would seem to be consistent with the further definition of taxable income contained in the recently issued rules and regulations on the implementation of the JVIT law.


Under these rules and regulations taxable income is computed according to formulas that differ depending on whether the enterprise is engaged in industry, commerce, or

\textsuperscript{34} Art. 3, § 2 of the Joint Ventures Income Tax Law.

\textsuperscript{35} Art. 3 of the Joint Ventures Income Tax Law.

\textsuperscript{36} It may be noted that the definition of "gross profits" appears to be very similar to the definition of "income" (the income tax base) of the Consolidated Industrial & Commercial Income Tax. It therefore seems that the term "gross profits" could have been borrowed from the CICIT.

\textsuperscript{37} The full impact of the Detailed Rules & Regulations on joint ventures in China offers a fertile field for further critical analysis.
service trades. These regulations seek to define net income in each of these areas. A comparison of "gross profits" under the CICIT definition and "net income" as used in the Detailed Rules and Regulations reveals that the definition of taxable "net income" is at once more specific and of wider scope than the "gross profits" definition referred to above. "Net income" includes "non-operating income" profit from other operations, which the term "gross profits" does not, as well as gross sales (also included in "gross profits").

One item in the Detailed Rules and Regulations of the JVIT of importance to businessmen is the subtraction, from taxable income, of amounts previously paid for sales (CICT) taxes. Such subtraction lowers the tax base on which the income tax operates and, naturally, reduces the tax liability of the enterprise.

3. CONFLICTS AMONG THE NATIONAL TAXES

The degree of foreign ownership and management may determine the kind and degree of tax imposed upon an enterprise. While the JVA specifies that foreign investment must be at least 25% of the capital of the joint venture, it does not specify the maximum percentage of foreign ownership that the P.R.C. will allow in a joint venture. A foreign investor may be allowed to own over 50% of the capital of a joint venture. As noted previously, the P.R.C. would probably like to retain a minimum amount of management control over a venture. In this way, the Chinese partners could learn directly from the foreign partners about the technology and business techniques involved. Such control would also allow the P.R.C. to determine to some extent the course of conduct of enterprises in China.

38 Speech by Vice-Premier Li, cited in Buxbaum, Continuity and Change in China's Legal Theory and Practice Affecting Importing and Other Aspects of Foreign Trade, in NEW YORK PRACTICING LAW INSTITUTE, NEW LOOK AT LEGAL ASPECTS OF DOING BUSINESS IN CHINA 439, 447 (1979).
The JVA does not cover enterprises owned wholly by foreign investors. The P.R.C. would probably prefer to have controlling interest in all ventures. However, it now appears that the P.R.C. wants to obtain "up-to-date technology" even if it is through wholly foreign-owned enterprises. Recent legislation would allow such enterprises to operate in China. In addition, special economic zones in coastal areas have been established to facilitate the establishment of foreign-owned enterprises on Chinese soil. These zones will be discussed in further detail later in this article.

At present it remains unsettled which taxes and tax incentives should apply to wholly foreign-owned enterprises. However, if no new legislation is enacted on the subject, it may be assumed that "foreign residents and businesses they manage shall pay taxes according to the laws of the PRC." At the time this regulation was written the taxes it referred to were the CICIT and the CICT, so it seems that 100% foreign-owned enterprises should be subject to the CICIT and CICT.

An exemption from the CICT and CICIT may be bargained for in contract negotiations. The P.R.C. is granting exemptions from the consolidated taxes [CICT and CICIT] on an experimental basis.

It is notable that the language of the JVA can be interpreted to require the application of the CICT and the CICIT

39 See id. at 448. This willingness may be seen in the Regulations on Special Economic Zones in Guangdong Province, Beijing, September 2, 1980 (Xinhua).
40 Regulations on Special Economic Zones in Guangdong Province, supra note 37.
41 Id.
43 See Gelatt, supra note 10; Maruyama, supra note 31, at 12.
44 Maruyama, supra note 31, at 12.
regardless of the degree of foreign control. Article 2 of JVA states that "all activities of a joint venture shall be governed by the laws, decrees and pertinent rules and regulations of the People's Republic of China." This statement is used in several of the laws of the PRC and is confusing. Does it mean that a joint venture will be exposed to the CICIT and CICT or does it merely suggest that it shall be subject to other laws such as those on labor, contracts, and criminal law not specified in this law? A broad construction of the language of Article 2 appears to suggest that joint ventures will be subject to both the CICIT and the CICT, which are "rules and regulations" of the P.R.C. However, joint ventures probably should not be subject to the CICT for the following reason. The express purpose of the JVIT is to afford special treatment to those joint ventures which will contribute to China's technological development. The low tax rates offered by the JVIT will be negated if it is to be applied in addition to the CICIT since, as we have seen, the overall CICIT rates are almost twice that of the JVIT. In light of the avowed purpose of the JVIT, (i.e., to attract foreign investment in the form of joint ventures), a more reasonable interpretation of Article 2 would require that the JVIT replace the CICIT as the income tax applicable to joint ventures with foreign investment.

On the other hand, it appears that joint ventures will still be exposed to the sales tax (the CICT). The Detailed Rules and Regulations for the implementation of the JVIT make specific provision for the deduction of the sales tax. Although it is possible to negotiate for an exemption from the CICT, the few contracts to date seem to indicate that the Chinese want to leave open the possibility that joint ventures will be subject to this tax. As mentioned before, the exemptions from the CICT seem to be allowed on an experimental basis only. Of course, enterprises which have not obtained an exemption by contract negotiations may still enjoy an effective exemption if the Chinese tax authorities decide to forgo
collection of this sales tax. While this possibility is consistent with the grant of experimental exemptions to some foreign investors, it is not yet a demonstrated custom.

To sum up, the degree of foreign ownership does at least determine which income tax will apply to an enterprise. If the enterprise is a joint venture with some Chinese capital and control, then the JVIT should be the applicable tax. If the enterprise is wholly foreign owned, then in the absence of new legislation on the subject, the CICIT should be the applicable income tax.

B. LOCAL TAXES

An enterprise in the P.R.C. will encounter not only national but local taxes as well. The term "local taxes" refers to the taxes levied separately by the governments of provinces or their subdivisions. Local taxes provide funds for the operation of local government and local projects.

The national government may set the maximum and minimum limits on the percentage of the national tax that will be allowed as a local tax or surcharge. Within these limits, local governments have control over how much of the percentage they can demand as local taxes.45

As is true of the national government, the local governments may obtain revenue through sales and income taxes. In the case of sales taxes there is a one percent local surcharge on the amount of consolidated sales tax (CICIT) paid to the national government. Although this surcharge does not appear in the national CICT regulations it has been used for quite some time as a source of revenue for local governments.46

In addition to the local sales tax there are also local

45 As we shall see in Part II [p. 146], this enables local officials to offer tax incentives to attract investment to their province.

46 See Pomp & Surrey, supra note 6.
income taxes. These are local surcharges on the amounts of national income taxes paid to the national government. The first local income tax on enterprises was the local counterpart to the consolidated income tax (CICIT). As we have seen, this is the income tax applied to domestic Chinese enterprises. The local CICIT surcharge may be anywhere from ten to one hundred percent of the actual CICIT paid to the national government. 47

The second and most recent local income tax is the one collected from joint ventures. The JVIT law permits local governments to impose a local surcharge up to, but not to exceed, 10% of the actual amount of JVIT tax paid to the national government. 48 The local JVIT surcharge should replace the CICIT surcharge for qualified joint enterprises.

PART II TAX INCENTIVES OF THE PEOPLE'S REPUBLIC OF CHINA

A. NATIONAL TAX INCENTIVES

As noted earlier, tax incentives are financial inducements to investment which are offered through reductions in the tax owed to the P.R.C. Turning from our discussion of the functions of the Chinese tax laws, we now focus our inquiry upon the tax incentives present in those laws. We shall follow the development of these incentives in chronological order.

Prior to 1979 there were no codified tax incentives in the P.R.C. Any tax incentives that were made available had to be bargained for in direct contract negotiations. Since 1979, the P.R.C. has attempted to use rate reductions, tax exemptions, deductions of items from taxable income, tax refunds,

47 TAXES AND INVESTMENT, supra note 6.

48 Since the national JVIT rate is 30%, the actual local rate applied against national income is 3%, 10% of 30% being 3%. Total overall JVIT tax rate, the sum of national and local taxes, is therefore 33%.
tax credits, and other forms of tax incentives.

Tax incentives in China fall within two categories: foreign and domestic. The foreign tax incentives are contained within the Joint Ventures Act and the Joint Ventures Income Tax Law. They were specifically intended to attract foreign capital, trade, and technology to China.

Domestic tax incentives are contained with China's domestic-oriented tax system, i.e. -- the CICIT and CICT. Certain tax advantages for foreign enterprises and investments may be seen in the CICT and CICIT. However, since these domestic tax provisions were not specifically enacted to encourage foreign investment, these domestic tax incentives are not treated in this article.\(^\text{49}\) In the following, we shall examine the incentives provided by the joint ventures laws.

The Joint Venture Incentives

The joint ventures laws cover two forms of joint ventures. The largest group (by number of enterprises approved) is called the contractual joint venture. Under this type of joint venture the "foreign firms [partners] provide funds and equipment, while the Chinese side is responsible for land, factory premises, labor and management. The two parties share profits at an agreed ratio and all assets go to the Chinese side when the contract expires.\(^\text{50}\)

\(^{49}\) Old laws may apply where enterprises are wholly owned by foreign investors since joint ventures laws would not apply. Domestic laws such as the CICIT and CICT provide incentives for the production of agricultural goods, and of industrial rather than commercial goods. Tax rates on these enterprises are lower than on enterprises producing non-agricultural or commercial goods. These tax incentives were established at a time when the PRC was seeking to build up its heavy industries. Compare this with the present emphasis on light industries. They also protect nascent enterprises. As we saw earlier, the domestic laws may also protect foreign owned enterprises by exempting them from the CICT.

\(^{50}\) Joint Enterprises Development with Foreign Firms, Beijing (Xinhua) in Foreign Broadcasting Information Service, 12 December 1980, at L9. One would expect that in a contractual joint venture the foreign investor
The other type of joint venture the P.R.C. has approved (in far fewer numbers) is called the equity joint venture. In this type of joint venture, "both Chinese and foreign partners provide capital, management and share risks as well as profit and loss." This form of joint venture is not as highly favored as the contractual joint venture because its assets do not all go to the Chinese partner at the end of the contract. The relationship between the partners continues until assets are divided and distributed. We may recall here that article 7 of the Joint Ventures Act provides for the reduction or exemption from income tax for the first two or three profit-making years of a joint venture equipped with up-to-date technology. It seems likely that those ventures approved would be the ones from which the Chinese side would eventually obtain the technology.

Article 7 also provides for the "restitution" of a part of income taxes for foreign participants who reinvest any part of their net profits within Chinese territory. These provisions are expanded and clarified in the Joint Ventures Income Tax Law.

The Joint Ventures Income Tax provides tax rates that are lower than the overall CICIT rates. The maximum overall JVIT rate is 33%. The national rate is 30% and the maximum local tax rate is 3%. The maximum CICIT rate is the sum of the maximum national CICIT rate of 34.5% and the maximum local rate (100% of the national CICIT) of 34.5%, or a total of 69%. Others have noted that the usual local tax is 60% of the national CICIT and have therefore calculated the effective overall CICIT tax rate as 55%. There is therefore an incentive to joint ventures with foreign investment relative to
domestic enterprises. If the CICIT applies to wholly foreign owned enterprises, then the JVIT would also seem to encourage foreign investment in joint ventures relative to investment in wholly foreign-owned enterprises. Again, this may be part of the P.R.C.'s desire to have some degree of management level control over enterprises in China.

The JVIT rates also have a relative incentive effect as compared to the taxes of other nations. The Joint Ventures Income Tax rate is "lower than the corporate tax rates generally used by Industrially developed nations." If this were the only major tax the enterprise in China faced then the low joint ventures income tax would clearly be an inducement to invest in the PRC as opposed to other countries. However, there are other income and sales taxes that joint ventures and other enterprises may be subject to, for example, the CICT and the CICIT. The addition of these other tax burdens may cancel the JVIT incentive effect by raising overall tax liability to that of other nations. The CICT and CICIT existed in China long before the JVIT was adopted and they are still in force today. As mentioned above, because an item in production may be taxed as many times as it is transferred in production, the sales tax (CICT) has the greatest impact on enterprises in China.

The Joint Ventures Income Tax law also provides that newly established joint ventures scheduled to operate for a period of at least ten years may be **exempted** from income tax in the first profit making year and allowed a 50% **reduction** in the second and third profit-making years. Although the JVA, article 7, states that the use of up-to-date technology would qualify a joint venture for the tax exemptions and reductions, the JVIT does not say anything about such technology. However,

54 Joint Ventures Income Tax law, article 5.
it does not appear likely that the P.R.C. will authorize joint ventures which do not use up-to-date technology.\textsuperscript{55}

Accordingly, most joint ventures operating under the JVIT should be using up-to-date technology. Article 5 of the JVIT would therefore seem consistent with article 6 of the Joint Ventures Act. It would also seem to be a specification of what the exemptions and reduction would be for a joint venture equipped with up-to-date technology.

Other tax laws have been enacted since 1979 which offer "special provisions" for enterprises exploiting the natural resources of China.\textsuperscript{56} This would seem to be directed toward reducing China's dependence on imported fuel and raw materials. This action would also eventually cut down on initial costs for materials and would therefore lower the cost of finished products. In turn, this would make the finished products of China more competitive on the international markets.

The national resources area is a good example of the way in which tax incentives are being used in place of direct expenditures. To otherwise exploit these natural resources the P.R.C. might have to inject funds into a state enterprise or make a direct payment to the foreign company to induce it to exploit China's natural resources. By using tax incentives the P.R.C. can make it more attractive to a foreign investor to help the P.R.C. fill its own needs.

Article 5, section 2, of the JVIT provides incentives for investment in such much needed but low profit earning activities as farming, forestry, and enterprises "located in outlying underdeveloped areas."\textsuperscript{57} Such low-profit operations are

\textsuperscript{55} See note 1 supra.

\textsuperscript{56} Bonavia, supra note 18. Art. 3, § 2 of the JVIT law.

\textsuperscript{57} This additional incentive is aimed, in part, at correcting the lack of development and the underutilization of vast amounts of hard-to-reach areas in China. In the past, a lack of resources and the great distances involved in reaching these areas prevented the development of such areas. It may still not be feasible for enterprises to use these areas even given the tax incentives.
to be given a 15 to 30 per cent reduction in income tax for the fourth through fourteenth profit making years. This would be in addition to the exemption and reductions provided to all other enterprises for their first years of profit.

Two provisions of the JVIT are directed at keeping investment in China for the long run. The first of these is article 6 of the Joint Ventures Income Tax Law. It provides for a 40% refund of the amounts of tax on the profits reinvested by a joint venturer in China, if the reinvestment is not withdrawn for at least five years. A recapture clause for the full amount of taxes refunded is utilized if the funds reinvested are withdrawn before five years have passed. These provisions, in effect, grant an extra measure of after-tax profit for funds reinvested in China.

Article 7 of the JVIT is the second provision that is directed toward keeping investments in China. It provides that losses may be carried over to the next tax year and made up with a matching amount drawn from that year's income. There is a five year carry forward of any losses exceeding the income of that year. These provisions operate to maintain the investments in China by making reinvestments more attractive and subsidizing losses by allowing reduction of liability in later years.

A final possible tax incentive in the domestic tax sphere is the accelerated depreciation of capital assets. To that end the P.R.C. has been experimenting with depreciation methods. While at present the P.R.C. usually only allows straight line depreciation, joint ventures may apply for accelerated depreciation of fund assets. Applications to use accelerated depreciation or to modify the depreciation

58 Maruyama, supra note 31.
59 Detailed Rules and Regulations of the JVIT, article 12.
60 Id. art. 13.
method are to be submitted for examination by local tax authorities and then "relayed level by level to the Ministry of Finance of the People's Republic of China for approval."

An application could be tied up in review indefinitely. A lack of administrative resources to handle the bookkeeping and computation of many different depreciation methods would seem to be the reason behind the resistance to changes in method. However, if the P.R.C. wants the technology or services a foreign partner could offer then the joint venture could probably get approval of its depreciation method. In any event, if the depreciation of fixed assets is an important consideration of a foreign investor, as it may be in industry and construction, then it might be wise to negotiate this point and make application for a depreciation method before investing in China.

All of the national tax incentives mentioned above indicate that China is intent on developing plans for a stable environment for foreign investment. It seeks to reduce short-term risks of losses by giving inducements in the early years of a joint venture. In enterprises like the contractual joint venture, the foreign investor hopes to make a return on his investment in the early profit making years of the enterprise. A stable, low-risk environment in the short term is what he would probably look for to guarantee the investment and return. The tax incentives examined above provide inducements for such enterprises. That is, tax breaks are granted for the early profit making years.

Tax breaks at the local level also encourage this type of enterprise. We shall now briefly turn to this area of tax incentives.

61 Id.
62 See p. 142 supra.
B. LOCAL TAX INCENTIVES

National tax incentives serve to draw foreign investment to China. In much the same manner local tax incentives may serve to draw investment to certain geographic areas (provinces) within China.

As was noted above, local taxes are calculated as a percentage of the amount of national tax paid. Therefore, any reduction in national tax liability will result in the reduction of local tax liability. Within that framework local governments may independently offer local tax incentives to enterprises establishing themselves in their geographic area. These tax incentives are usually in the form of a reduction or exemption from the local surcharge on the national taxes for a set period of time.

As previously noted [p. 139, supra], the JVIT law permits local governments to impose a local surcharge up to, but not to exceed, 10% of the actual amount of JVIT taxes paid to the national government. The ten percent maximum limit on the local income tax for joint ventures compares favorably to the ten to one hundred percent local income tax surcharge limit for Chinese enterprises under the CICIT. In terms of actual rates operating on the national tax base, the JVIT rate is 3% (10% of the national tax rate of 30%), as compared with the average [using Reynold's figures] actual local CICIT rate of 20.7% (60% of the maximum national tax rate of 34.5%). Thus, joint ventures are given a more preferable treatment on a local level than other enterprises. Local governments may increase or decrease the relative preference by varying the rates for each tax. For example, if local officials set the JVIT local surcharge at its maximum (10%), and the local CICIT surcharge at its minimum (10%) of the national tax, then there would be little preference. Conversely, if the local JVIT surcharge were set at its minimum (0%), and the local CICIT surcharge were set at its maximum (100% of the national tax),
then the preference would be at its greatest. Local officials can therefore exert influence on foreign investors' decisions to invest in their province.

The aforementioned reductions and exemptions from local taxes are the only local tax incentives in the People's Republic of China at this time. There are, however, experimental projects in certain provinces which may offer lower tax rates than other local areas as well as possible exemptions from the national taxes. These projects, called the "special economic zones," present several tax related problems. These problems are explored below.

C. SPECIAL ECONOMIC ZONES

In 1980 the People's Republic of China established special experimental areas for the development of industry and trade. These are the special economic zones. One such special economic zone was established by the Regulations on Special Economic Zone in Guangdong Province. These regulations contain for provisions applicable to enterprises in these zones. Special economic zones are a unique extension of the concept of attracting investment to a particular geographic area. The geographic areas involved in the special zones are coastal areas; areas which China has used in the past as trade zones for foreigners in China. The incentives the special zones offer may in fact be a hybrid of national and local tax incentives. The special zones were established by the National People's Congress but like other local taxes and tax incentives, the taxes in the special zones are, in application, controlled by local government. Unlike local taxes, the Regulations on special zones may offer a potential exemption

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63 Regulations on the Special Economic Zones in Guangdong Province [hereinafter cited as the Special Economic Zones Regulations].
64 Id.
from the national income taxes, offering in its place a reduced income tax rate of 15%. They may also offer exemption from the sales taxes, such as CICT.

The regulations state that the "rate of income tax levied on the enterprises in the special zones is to be 15%." Presumably this rate would replace the JVIT and CICIT as the income tax applicable to enterprises in the special zones. If it were not replaced in this manner the joint venture would be faced with a higher total income tax (30% national plus 15% local, total of 45%, as opposed to 33% regularly) than joint ventures outside special zones.

Conflicts of Laws of Special Zones and National Taxes

Difficulties concerning conflict of laws arise in determining which tax laws are applicable to foreign owned enterprises in special zones. Appropriate questions here would include whether these enterprises are subject to national taxes, or are merely subject to local taxes, or are merely subject to special zone tax rules.65 The Act establishing the Guangdong Special Zone contains the provision stating "enterprises and individuals in the special zones must abide by the laws, decrees and related regulations of the People's Republic of China."66

This statement is similar to one contained in the JVIT. Unfortunately, its meaning remains ambiguous and confusing. The language of this provisions seems to indicate that enterprises in the special zones would be exposed to the JVIT and the Consolidated Industrial & Commercial Taxes since they are national laws. In support of this conclusion, it may be argued that since the special zone regulations do not have specific provisions exempting enterprises in the zone from

65 For example: Art. 14 of the Regulations on Special Economic Zones in Guangdong Province.
66 Id. art. 2.
national taxes, they are still subject to national taxes. However, the better view may be that the special zone regulations take precedence over and perhaps to the exclusion of the national taxes, including the recent Joint Ventures laws. According to this view, the provisions may merely reflect an attempt by the P.R.C. to cover itself in areas not specifically covered by the regulations. This would allow the Chinese to maintain jurisdiction over these areas. Such a provisions would make it clear that the laws of the P.R.C. in these areas must be followed in pursuing certain tax advantages. This view seems to be consistent with the intent of the subsequent provision of the Special Economic Zones Regulations. The provision indicates that the national taxes may not apply to enterprises in the special zones. It has been translated in at least two ways: first as, "...with the exception of special provisions as stipulated in these regulations." and secondly as, "[w]here there are specific provisions contained in the present regulations, they have to be observed as stipulated here." These translations seem to indicate that the provisions of the Special Economic Zones Regulations take precedence over or replace national laws to the contrary.

Since the regulations for the Special Economic Zones make specific provision for the applicable income tax, it would appear that the enterprises in the special zones may only be subject to the provisions of the Guangdong Special Economic Zone Regulations to the exclusion of the national Joint Ventures and Consolidated Industrial & Commercial Income Taxes. This interpretation would seem consistent with the special zones regulations' stated purpose of developing "external economic cooperation and technical exchanges and promot[ing]


68 Regulations on Special Economic Zones in Guangdong Province, Beijing (Xinhua) 2 September 1980, reprinted in 3 MONSOON, p. 11.

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the socialist modernization program. [F]oreign citizens,... and their companies and enterprises... are encouraged to open factories or set up enterprises... with their own investment or undertake joint ventures with Chinese investment...." 69

This interpretation would suggest that an enterprise in the zone would only be subject to a 15% rate of taxation on income unencumbered by the burdensome national CICT tax (up to 69% rate), CICIT tax, (5 to 34.5% rate), and Joint Ventures Income Tax (30%). Since corresponding tax rates in other parts of Southeast Asia, such as Hong Kong, are higher, the lower tax rate would be a highly desirable condition for investment in that part of the world.

In addition to an initial low rate of taxation, the special zones also offer "special preferential treatment" if the enterprise is (a) established within 2 years of the promulgation of the special zone regulations, or (b) has investment of US $5 million or more, or (c) involves higher technology or a longer cycle of capital turnover. 70 What that treatment will be has not yet been defined. Again, technology is stressed as highly desirable in the industries the P.R.C. seeks to attract.

Article 16 of the special zone regulations provides an exemption from income tax on the profits reinvested in the special zones for five years or longer. 71 Although not explicitly stated, presumably a recapture provision similar to that of the Joint Ventures Income Tax Law would apply in the case where the investments were withdrawn before the end of the five year period.

69 Id.
70 Id. art. 14.
71 Id. art. 16. This may be essential since it has been estimated that it would otherwise take at least 5 years for a venture in China to yield a return sufficient to warrant the investment.
Double Taxation

One other problem the P.R.C. has tried to solve through tax incentives in its Joint Ventures laws has been the double taxation of income derived from China. Double taxation arises where two sovereigns claim to exercise tax jurisdiction over the same entity. Thus, absent a provision eliminating double taxation, an American corporation participating in a joint venture in China may be required to pay both U.S. and Chinese taxes on the same income.

The Chinese tax incentives may only be effective if the laws of the investor's country of residence make provision for the elimination of double taxation. There are two methods for eliminating double taxation -- the foreign tax credit system and the foreign tax exemption system. Under the tax credit system, the Chinese tax incentives will generally have no incentive effect for a foreign investor with foreign investments only in China. Any reduction in Chinese income tax liability is offset on a "dollar-for-dollar" basis by a corresponding increase in income tax owed to the country of residence. The overall tax liability of the investor is therefore not reduced by the Chinese tax incentive.

To avoid the problem of double taxation and provide tax neutrality for residents of China, the P.R.C. has enacted an income tax credit against taxes owed to China for income taxes paid to other countries. For U.S. investors, income taxes paid to China may also be eligible for the U.S. foreign tax credit. This would be a welcome change from the non-credit status of the CICT.

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72 Joint Ventures Income Tax law, article 16. Note that tax neutrality is also provided by taxing non-residents only on income derived from China.

73 United States I.R.C., §§ 902, 903 et seq.

74 Gelatt, supra note 10, Pomp & Surrey, supra note 6. See Reynolds, supra note 5.
In the United States, the CICT may be deducted from gross income under I.R.C. § 162 as an ordinary and necessary business expense of a trade or business, or under I.R.C. § 164 as a deductible foreign tax. However, the benefits of a deduction under one of these sections is not the "dollar-for-dollar" offsetting of tax liability that the foreign tax credit affords. Consequently, there remains some degree of double taxation of U.S. investments in China.

For foreign investors in tax exemption countries, such as most European countries, the Chinese tax incentives generally will have an incentive effect since there is no residence country income tax on that income to offset the reduction in Chinese taxes.

However, there exist exceptions and special situations where a foreign investor from a country which uses a "tax credit" system may still experience an incentive effect from China's tax system. For example, tax incentives may be effective incentives to investment where the taxpayer is allowed to average foreign income over many countries or where foreign income tax is deferred to a later tax year.

As may be seen, the tax incentive effect experienced by foreign investors in China will depend on the interaction of their resident countries' tax laws with the Chinese tax provisions discussed above. A detailed analysis of that interaction, not attempted in this article, would be necessary for a full understanding of the incentive effect of the Chinese tax laws on specific investments made by American and other foreign investors.

75 See generally McDANIEL & AULT, INTRODUCTION TO UNITED STATES INTERNATIONAL TAXATION 69-70 (1977).

76 The foreign investor may derive some benefit from the deferral of income tax allowed when dividends from a subsidiary corporation are delayed. The tax on the income is deferred until such dividends are remitted to the parent corporation or investor in their county of residence.
Finally, an alternative means to provide tax incentives that has yet to be used may be tax treaties or agreements. Tax treaties or agreements may be used to alter or exempt enterprises from laws that would otherwise affect foreign individuals and businesses in China.\textsuperscript{77} They may also provide for consistency in the definition of terms, tax bases, and applicable rates. No such treaty has been concluded between China and the U.S.

\section*{CONCLUSION}

We have seen that the P.R.C. employs a tax system which embraces several independently operating national and local taxes. A foreign investor in China may have to deal with both levels within the Chinese tax system.\textsuperscript{78} The Joint Ventures Income Tax is one of the P.R.C.'s first attempts to deal with foreign investment on Chinese soil. While foreign investors in China cannot afford to ignore the impact of the various national and local taxes upon foreign investments in China, their primary concern may be most effectively focused upon the Joint Ventures Income Tax and the national sales tax (the Consolidated Industrial & Commercial Tax).

Other laws may follow dealing with foreign enterprises in forms other than joint ventures. However, it appears that most investment will occur in the form of contractual joint ventures since this represents the most beneficial form of investment to the P.R.C. and is therefore the most likely to receive official approval. Under this form of joint venture the P.R.C. would obtain all the assets of the venture upon termination of the contract. In addition, the stable short-term environment and early tax incentives offer an attractive

\textsuperscript{77} Individual Income Tax law, art. IV, § 8. Joint Ventures Income Tax law, art. 16.

\textsuperscript{78} Local taxes may only be avoided if the province involved decides to maximize the incentive it offers by reducing local taxes to zero percent.
inducement to the foreign investor who is looking for a worthwhile return on his investment in China.

By offering incentives to certain joint ventures the new tax system may also be viewed as a kind of screening process. By initiating this screening process at the contract level, the P.R.C. can exert a modicum of control over the kinds of investments that are deemed most desirable. For example, particularly high priority will be afforded to those enterprises which (1) use "up-to-date technology"; (2) exploit oil, gas, and other natural resources of China; or (3) are "located in outlying, underdeveloped areas."

In conclusion, it may be observed that the tax incentives of the P.R.C. represent a balance between tax revenues and tax inducements to investment of technology and assets in China -- a balance that has been struck in favor of the inducements. China is also apparently experimenting with its many taxes in order to maximize the efficacy of its tax incentive network. Finally, China's tax incentives may only be effective inducements to desired foreign investments if the laws of the investor's country of residence do not cancel out the incentive effects by adding its own taxes upon the income derived from joint ventures in China.

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