

INTERPRETATION OF TAX LAW IN CHINA: MOVING TOWARDS THE RULE OF LAW?



Dongmei Qiu*

A unique feature in the interpretation of tax laws in China is that administrative organs have enjoyed a near monopoly status in interpreting rules. The high centralization of powers combined with the lack of effective checks leads to various problems which in turn jeopardize the legitimacy of interpretations made by administrative organs. This article points out that, in the short run, while this monopoly status will not be changed fundamentally, the problems may be alleviated through the “self-constraints” adopted within the government and applied in order to comply, more effectively, with the requirements of the “rule of law”. Meanwhile, external factors are playing an increasingly important role in shaping the development and interpretation of tax law, including the supervision from civilians, tax professionals and non-government organizations as well as the influence of the international tax community.

I. Introduction

To understand the interpretation of tax law in China, the first and foremost question to explore is not the methodology but the allocation of interpretative powers.¹ In China, the interpretation of law, in general, based on the directive of law interpretation² and the Law of Legislation, is considered to be a power distributable among the legislature, judiciary and administrative organs. In the field of tax law, this power is, in practice, predominantly exercised by administrative bodies, especially the State Administration of Taxation (SAT) and the Ministry of Finance

* Postdoctoral fellow at Hong Kong University; Research fellow, Center for International Tax Law and Comparative Taxation, Xiamen University. I would like to give special thanks to Prof. Richard Cullen at the University of Hong Kong for valuable input to the writing of this article. I am also grateful to the anonymous reviewer for the constructive comments. As this article is based on earlier work carried out for the book “*Legal Interpretation of Tax Law*”, I would like to thank the book editors, Dr. Robert van Brederode and Prof. Rick Krever, for their kind support. Any errors, however, remain the responsibility of the author.

¹ See Wu Jingsong, “Reflection on Tax Administrative Interpretation in China” (in Chinese) (2010) 3 *Taxation Research* 69–72; Hu Yuhong, *Principles and Techniques of Law* (in Chinese) (China University of Political Science and Law Press, 2002) 45.

² See *Resolution on the Provision of an Improved Interpretation of Law*, adopted in the 19th Meeting of the Standing Committee of the Fifth National People’s Congress (NPC), May 1981. For more detailed discussion, see Section II.

(MoF), whereas the judiciary and the legislature play very limited roles. The legislature in China has been largely absent from the tax legislative work and has delegated its powers on tax legislation to the administrative bodies. This leads to the effect that the interpretive activities carried out by the latter bodies often have a legislative nature *de facto*.

The aim of this article is to address the following three questions. What are the causes leading to the high centralization of interpretative powers in the hands of administrative bodies in the field of tax law? How are the tax rules interpreted by administrative organs in practice? What are the development trends that we may see in the future?

The first question is explained from two aspects in Sections III and IV. Firstly, in terms of the legislative interpretation, although the legislative body, namely the Standing Committee of the National People's Congress (SCNPC), is given the exclusive power to interpret the statutes,³ the interpretations given by the SCNPC on tax statutes are close to none.⁴ The absence of the SCNPC in interpreting tax statutes is closely related to the devolution of the tax legislative powers in the mid-1980s, which led to the dominance of rules issued by lower authorities governing the tax law systems. Second, the courts' role in the interpretation of tax rules has been marginalized. Judicial interpretation in the meaning of tax rules by the Supreme People's Court (SPC) is rare. It is very seldom that the courts voice constructive opinions in cases regarding the application of tax rules. The author attempts to explore the underlying reasons for these developments from the cultural, legislative and institutional perspectives.

The second question is analyzed in Section V. The author reviews the regulatory framework to explore the allocation of the interpretative powers between the State Council and its two ministries, ie the SAT and the MoF. The high centralization of interpretative powers on the SAT and the MoF causes problems which can be illustrated by the example of interpreting anti-avoidance tax rules under the Enterprise Income Tax Law (EITL). Despite all the infirmities, the author argues that there are still promising developments as the SAT, driven by the intrinsic regulatory constraints, is moving itself so as to adhere more closely to basic rule of law principles which requires predictability, transparency and legitimacy. Lastly, how the SAT and the local tax agencies are interrelated on the interpretation of tax law is explored.

³ The interpretative power enjoyed by the legislature is provided in the Constitution and the Law of Legislation. See Section II.

⁴ There are very few interpretation issued by the SCNPC on the tax statute. These tax related interpretations are tax crimes, such as SCNPC, Interpretations on the Provisions Regarding "Other Invoices for Export Rebate and Tax Offset" of the Criminal Law in PR China, promulgated and effective on 29 December 2005.

As to the third question, the author suggests three possible routes via which compliance with “rule of law” principles by China’s tax administration in their interpretative activities may be improved. Route one is to strictly define the interpretative powers of the administrative organs so that these powers will not trespass on the legislative powers exercised by the legislature. The first step, to further this aim, is for the legislature in China to reclaim its legislative powers in the tax law arena which are currently retained by administrative organs. Second, the awakening awareness of Chinese civilians on the “rights as taxpayers” and the increasing involvement of tax professionals and non-governmental entities can be another force to push the tax administration to be more attentive to the legality of their interpretative activities. Thirdly, China’s role as a major emerging economic power and its intention to comply with international norms compels the SAT to join the dialogues with other countries and international organizations, typically the OECD and the UN, in formulating its interpretative rules. As argued by the author in Section VI, while implementing the rule of law principle in the interpretation of tax law in China will be a long-run process, clear and positive signs have emerged to show that China is moving towards this direction by the means of these three routes.

II. Brief Introduction to the Interpretation of Tax Law

In China, the Constitution provides little guidance on matters of legal interpretation except for a brief mention of the power of the SCNPC to interpret the Constitution and statutes.⁵ While there is no single law on the interpretation of legislation, the existing scheme of legal interpretation is mainly based on the “1981 Resolution” adopted at the meeting of the SCNPC.⁶ Based on this Resolution, the interpretative powers of law in China are distributed to the legislature, judiciary and executive organs. The two highest judicial organs, the SPC and the Supreme People’s Procuratorate (SPP),⁷ have the powers, respectively, to interpret questions involving the specific application of laws from the court trials and the procuratorial work. For questions involving

⁵ Articles 67(1) and 67(4), Constitution of the People’s Republic of China, adopted at the Fifth Session of the Fifth NPC on 4 December 1982, and the latest revision is on 14 March 2004.

⁶ Resolution on the Provision of an Improved Interpretation of Law, adopted in the 19th Meeting of the Standing Committee of the Fifth NPC, May 1981.

⁷ The SPP is the highest agency at the national level responsible for both prosecution and investigation in China. It is mainly responsible for supervising regional procuratorates and special procuratorates to perform legal supervision by law. The SPP has to report its work to the NPC and SCNPC, to whom it is responsible, and accepts their supervision.

the specific application of laws unrelated to judicial or procuratorial work, the State Council, the highest executive body in China, together with the responsible departments, shall provide interpretation.⁸ Above all, the SCNPC has the power to interpret statutes through making additional stipulations whenever there are loopholes in existing statutes or contradictory interpretations given by the SPC and the SPP.⁹

While the 1981 Resolution was meant to draw a clear delineation on the interpretative powers among different organs, it failed to do so due to the inherent ambiguities and contradictions.¹⁰ The problems underlying this Resolution were inevitable due to the following fact: in China, all the government organs, including legislature, judiciary and the executive, are subordinate to the leadership of the Communist Party and the law is expected to cope with the changing policies of the Party from time to time.¹¹ To achieve this purpose, the interpretation of law needs to retain a high degree of flexibility so that the law can be changed swiftly to adapt to the varying political situations.

But this flexibility has its cost and leads to frustrating aftermaths: the overlap of interpretative powers among different organs, the lack of transparency in the interpretative process and the lack of standardized usage of titles and the legal-effects obscurity of these interpretive rules.¹² Many of these problems penetrate into the interpretation of tax law except one: in the tax field, the overlap of interpretative powers among the legislature, judiciary and the execution rarely occurs.¹³ It is the executive bodies, namely the State Council and its ministries typically represented by the SAT and the MoF, that have played the leading and predominant role in the interpretation of China's tax law. Although the legislative bodies and judicial organs have been authorized to interpret the tax law nominally, their powers have *actually* lain dormant in practice.

⁸ Article 3, 1981 Resolution.

⁹ Articles 1 and 2, 1981 Resolution.

¹⁰ See Kong Xiaohong, "Legal Interpretation in China" (1990) 6 *Connecticut Journal of International Law* 491, 497; Zhou Yongkun, "The Conflict between Legal Interpretation and Government in Accordance with a System of Law" (in Chinese) (2006) 27 *Modern Law Science* 5; Wei Shengqiang, "Who shall Interpret the Law—Consideration on the Allocation of the Law Interpretative Powers in China" (in Chinese) (2006) 3 *Legal Science* 38–47.

¹¹ See Mo Zhang, "The Socialist Legal System with Chinese Characteristics: China's Discourse for the Rule of Law and a Bitter Experience" (2010) 24 *Temple International & Comparative Law Journal* 1–64.

¹² See Wei Shengqiang, "We Need a Uniform Legal Interpretation Law" (in Chinese) (2007) 1 *Legal Science* 33–34.

¹³ See eg Wu Jingsong, "Reflection on Tax Administrative Interpretation in China" (in Chinese) (2010) 3 *Taxation Research* 69–72; Sun Jianbo, *Research on Tax Law Interpretation* (in Chinese) (Law Press, 2006) 239–259; Li Danmei, "Study on the Interpretation of Tax Law" (in Chinese) (2003) 3 *Finance and Tax Law Review* 294–296; Cai Qiaoping, "Issues of Reduction in Effectiveness of China's Tax Law" (in Chinese) (2002) 2 *Finance and Tax Law Review* 156.

III. Missing Voice of the Legislative Body in the Interpretation of Tax Law

The Law of Legislation¹⁴ provides the legal basis for the SCNPC¹⁵ to interpret statutes. Under Art 42, the SCNPC shall provide the interpretation on a particular statute whenever a provision of the statute is ambiguous or the statute, after the enactment, needs further clarification to address new situations. The legislative interpretation given by the SCNPC on the statute has the equal legal effect as the statute. This power, however, was rarely exercised by the SCNPC in the tax field.¹⁶ The reasons can be understood by reviewing the current status of tax legislation in China.

The existing framework of tax law in China stands as a pyramid with three tiers: on the top are four statutes legislated by the NPC and the SCNPC, namely the Law on the Administration of Tax Collection, Individual Income Tax Law (IIT Law), ETIL, and the Vehicle and Vessel Usage Tax Law (VVUT Law). The three types of taxes governed by the statutes are IIT, EIT and VVUT, which stand out among the 18 types of taxes China currently have. They have generated around a quarter of tax revenue in the year of 2013.¹⁷ That is to say, the other 15 types of taxes which account for nearly three quarter of tax revenue in China are provided by the rules with a lower rank of legal effect. A common feature of the four tax statutes is that they are strikingly short in length and concise in content.¹⁸ They normally contain the broad principles of fundamental tax matters and leave the detailed provisions to be dealt with by implementation regulations issued by the State Council.

On the second tier are the regulations issued by the State Council which number more than 20. Under the Law of Legislation, the State Council is empowered to adopt administrative regulations, rules and measures to carry out laws enacted by the NPC and the SCNPC.¹⁹ This power has

¹⁴ National People's Congress, Legislative Law of the People's Republic of China, Order of the President [2000] No. 31, promulgated on 15 March 2000, effective on 1 July 2000.

¹⁵ The NPC and its standing committee, i.e. SCNPC, are the highest legislative body in China.

¹⁶ Note 4 above.

¹⁷ Based on the statistics released by the MoF, the total tax revenue in China amounts to more than RMB 11 trillion in the year 2013. The revenue from the EIT is RMB 2241.6 billion, while the revenue from the IIT is RMB 653 billion. The VVUT is a small tax levied on the usage of vehicle and vessel either according to the number of taxable vehicles or the net-weight capacity of the taxable vehicles. It generates less than one percent of the total tax revenue in China. See http://gks.mof.gov.cn/zhengfuxinxi/tongjishuju/201401/t20140123_1038541.html (visited 14 Apr 2014).

¹⁸ For instance, there are only 15 articles in the Individual Income Tax Law, 60 articles in the Enterprise Income Tax Law and 13 articles in the Vehicle and Vessel Tax Law. The longest statute is the Law on the Administration of Tax Collection with 94 articles.

¹⁹ Article 9, Law of Legislation.

been exercised by the State Council through setting out implementation rules for tax statutes.²⁰ The NPC or the SCNPC also delegates some of their legislative powers to the State Council. The State Council has used this delegated power to introduce most of the taxes in China, including the value-added tax (VAT), business tax, excise tax, customs duty, etc.²¹

At the bottom of the pyramid are the ministerial regulations issued by the SAT and the MoF which number more than 50. The “ministerial rules”, according to the Law of Legislation, refer to the rules that meet four criteria: (1) enacted by the SAT to implement the tax statutes, or administrative regulations, decisions and orders of the State Council; (2) passed by a ministerial session or a committee of the SAT; (3) promulgated by the head of the SAT in the form of an order and (4) published in a timely manner in the Bulletin of the State Council or of the SAT and nationwide via circulated newspapers.²² In addition, there is a vast body of informal tax rules the SAT and the MoF have pronounced which run into the thousands.²³ These rules are not accorded the status of law. Previously, many of them were classified as internal and were restricted to use and circulation within tax agencies. But they do provide important guidance to taxpayers and tax agencies. Due to their practical importance and the increasing requirement to comply with rule of law principles, most such rules are now publicly available.

It is clear that the main body of the existing tax rules in China has been spelled out by administrative organs rather than the legislature. While the legislative powers have been largely delegated to others, the SCNPC seems to have little interest to retain the power to interpret tax law. Why did the SCNPC, despite the significance of the tax legislation to a country, grant its legislative power to administrative organs with few constraints? The reasons can be traced back to the early 1980s.²⁴ At that time, with the economic transition and open-door policy gathering

²⁰ See eg Implementing Regulations of the Law on Enterprise Income Tax, promulgated under the Order of the State Council [2007] No. 512, 6 December 2007; Implementing Regulations of the Individual Income Tax Law, promulgated under the Order No. 142 of the State Council on 28 January 1994 and most recent revision was on 19 July 2011; Implementing Regulations of the Vehicle and Vessel Tax Law, adopted on 23 November 2011 and came into effect on 1 January 2012.

²¹ See eg Interim Regulations on the Value-added Tax, promulgated under the Order No. 134 of the State Council on 13 December, 1993 and revised on 5 November 2008; Interim Regulations on Business Tax, promulgated under the Order No. 136 of the State Council on 13 December 1993 and revised on 5 November 2008; Provisional Regulations on Consumption Tax, promulgated under the Order No. 135 of the State Council on 13 December 1993 and revised on 5 November 2008.

²² Articles 74–77, Law of Legislation, promulgated under the Order of the President [2000] No. 31 on 15 March 2000, effective on 1 July 2000.

²³ According to the rough calculation, the SAT and the MoF has issued more than 5000 informal tax rules. Currently, about 3000 of them are in effect.

²⁴ See Liu Xin and Wang Lingguang, “Statutory Taxation and Legislation Reservation” (in Chinese) (2008) 3 *Administrative Law Review* 83.

momentum, one of the daunting and urgent tasks facing the Chinese government was to build a legal system from scratch to meet the changing policies. This was a big void which could not be filled quickly. Given the limited competence of the legislature, the SCNPC made sweeping delegations of legislative powers to the State Council, and in the tax fields, the delegation was based on two directives.²⁵ Under one of the directives (the 1985 Directive) which is still in effect today, the SCNPC gave blanket permission to the State Council to make rules or regulations regarding all tax issues relating to “reform of the economic system and opening to foreign countries”. The scope of this delegation was so broad and vague as to cover nearly every economic activity. Contrary to the provisions in the Law of Legislation,²⁶ the State Council also re-delegated such legislative powers to its ministries to make detailed tax rules. The devolution of legislative powers, as such, which was originally designed for transitional and experimental purposes, continues to operate today.

Despite the steady enhancement of the institutional capacity within China’s legislature in the past three decades,²⁷ the NPC and the SCNPC made very little progress to reclaim its tax legislative power. While China has been experiencing a new round of tax reform since 2008 and significant changes occurred in the rules related to VAT, business tax, real property-related tax, resources tax, consumption tax, etc.,²⁸ none of these took place under the involvement of the NPC and the SCNPC. There is only one exception: the VVUT Law was escalated from the regulation to the statute level in 2011.²⁹ The passivity of the legislative body can be partly attributed to the nature of tax law as being too specialized and technical to be grasped by the delegates of the NPC and the members of the SCNPC who lack

²⁵ Decision of the NPC Standing Committee to Authorize the State Council to Reform the System of Industrial and Commercial Taxes and Issue Relevant Draft Tax Regulations for Trial Application (issued on 18 September 1984 and repealed on 27 June 2009); Decision of the NPC on Authorizing the State Council to Formulate Interim Provisions or Regulations Concerning Economic Structural Reform and Open Policy (10 April 1985).

²⁶ Under Arts 10 and 11 of the Law of Legislation, the delegation of legislative powers shall be specific in terms of the objective and the scope. The organ that was delegated with legislative powers shall not re-delegate its authority to others. The delegation of legislative powers shall be terminated once the matters which were governed by the delegated powers were considered appropriate to be subject to the enactment of statutes by the NPC and SCNPC after the test in practice.

²⁷ For the discussion of the development of legislative system in the past 30 years, see Randall Peerenboom, *China’s Long March towards Rule of Law* (Cambridge University Press, 2002) 239–279.

²⁸ B Brys *et al.*, “Tax Policy and Tax Reform in the People’s Republic of China” (OECD Taxation Working Papers, No. 18, OECD Publishing, 2013).

²⁹ Before 2011, the vehicle and vessel usage tax was subject to the administrative regulation issued by the State Council. See State Council, Interim Regulations of the People’s Republic of China on Vehicle and Vessel Tax, Order of State Council No. 482, promulgated on 29 December 2006, effective on 1 January 2007. This regulation was repealed in 2011 as the SCNPC issued the law on vehicle and vessel usage tax which was described as the first statutory codification of the rules of a local tax. See SCNPC, Vehicle and Vessel Tax Law of the People’s Republic of China, Order of President No. 43, promulgated on 25 February 2011, effective on 1 January 2012.

both tax knowledge and practical experience. Whatever the excuses are, it is hard to justify the “standstill” of the legislature for the long run. There is an increasing call for the legislature to take action in the tax field.³⁰

IV. Marginal Role of Judicial Organs in the Interpretation of Tax Law

The judicial interpretation in China has two basic forms: one is the interpretation given by the SPC³¹ providing guidance for the trial of courts at all levels; the other is the interpretation rendered by a court in the adjudication of a specific case. In China, the lack of development of any serious case law tradition³² and the judicial mechanism internally inhibiting initiative and independence of judges³³ makes the SPC's interpretation the predominant form of judicial interpretation.³⁴

1. SPC's Interpretations on Tax-related Matters

The rules of an interpretative nature spelled out by the SPC are numbered at more than 3000.³⁵ However, only a handful of rules are related to tax matters. These tax-related interpretative rules mostly address procedural matters or tax crimes, such as the scope of the courts' jurisdiction,³⁶ the

³⁰ See eg Liu Jianwen, “How the Tax Legislative Powers may be Returned to the NPC” (in Chinese), *Economic Information Daily*, 27 March, 2013, p 5; Yuan Mingsheng, “The Legality Crisis of the Tax Administrative Crisis and the Solution” (in Chinese) (2010) 1 *Studies in Law and Business* 54.

³¹ According to Art 5 of the Provision on the Judicial Interpretation, the interpretation issued by the SPC has legal effect. See SPC, Provision on the Judicial Interpretation, *Fafa* [2007] No. 12, promulgated on 9 March 2007, effective on 1 April 2007.

³² While the cases in China generally and theoretically has no binding effect, it is notable that they are playing a more important role nowadays since the courts, including the SPC, launched the practice to regularly publish “classical cases”, “exemplary cases” or “guiding cases” as the reference for the courts trial. See eg SPC, Circular on Release of the First Batch of Guiding Cases, *Fa* [2011] No. 354, promulgated and effective on 20 December 2011; SPC, Notice on the Top Ten Case and Fifty Classical Cases on the Judicial Protection of Intellectual Property Rights in China's Courts in 2011, *Faban* [2012] No. 91, promulgated and effective on 11 April 2012; Intermediate People's Court of Chengdu, Measures on the Selection of the Exemplary Cases and Publication (26 June 2005), available at <http://cdfy.chinacourt.org/article/detail/2005/05/id/552569.shtml> (in Chinese).

³³ Ji Weidong, The Judicial Reform in China: The Status Quo and Future Directions (2013) 20(1) *Indiana Journal of Global Legal Studies* 189.

³⁴ Zhou Yongkun, “The Conflict between Legal Interpretation and Government in Accordance with a System of Law” (in Chinese) (2006) 27 *Modern Law Science* 7.

³⁵ Xin Chunying, Working Report on the Clean-up of the Judicial Interpretation addressed by the Sub-Committee of Legislative Affairs of the SCNPC on the second meeting of the 12th SCNPC, 23 April 2013.

³⁶ For example, SPC, Reply to the High People's Court of Jiangsu Province in Response to the Inquiry Regarding whether the Court shall Accept Tax Disputes Arising from the Qualification of Taxpayers, *Faxing* [2000] No. 31, promulgated and effective on 28 November 2001; SPC, Reply to the Inquiry Regarding whether the Court shall Accept Tax Disputes Arising from the Disagreement of Taxpayers on the Tax Assessment by the Tax Authority, *Faxing* [1992] No. 2, promulgated and effective on 8 January 1992.

standing of tax offices as the administrative body,³⁷ treatment of overdue tax payment under the civil laws,³⁸ the statute of limitations,³⁹ and tax fraud or evasion.⁴⁰ The scarcity of the SPC interpretative rules in taxation as well as the SPC's inactivity to elaborate opinions on substantive tax rules shows the clear intention of the SPC to distance itself from the potential conflicts with administrative organs by interpreting tax rules. Even so, the clash of the interpretations given by the SPC and the administrative body still occurs. The following is one example:

Under the existing laws, when a company goes bankrupt, the tax payment shall be given priority over the ordinary bankruptcy claim in the compensation regime.⁴¹ But, on whether this priority status can apply to the “overdue payment fee arising from the late tax payment”, the law is ambiguous and there are divergent views both in practice and academia. In *Fashui* [2012] No. 9,⁴² a reply to an inquiry from the High Court in Qinghai, the SPC opined that the overdue payment fee arising *before* the bankruptcy case accepted by the court falls under the “ordinary bankruptcy claim” whereas the fee arising *after* the bankruptcy case accepted by the court is outside the bankruptcy claim.⁴³ In any event, the overdue payment fee shall not be treated on the same footing as the “tax

³⁷ For example, SPC, Reply to the High People's Court of Fujian Province Regarding the Inquiry of the Standing of Tax Inspection Office of Local Tax Bureau as the Administrative Body, *Xingta* [1999] No. 25, promulgated and effective on 21 October 1999.

³⁸ For example, SPC, Reply in Response to Whether the Overdue Tax Payment of the Bankrupt Company are Subject to the Prescribed Period of the Bankruptcy Claim under the Bankrupt Law, *Fayan* [2002] No. 11, promulgated and effective on 18 January 2002; SPC, Reply on Whether to Accept the Lawsuits Lodged by Tax Authorities to Determine their Creditor's Rights to the Late Fees of Tax Arrears Incurred by Bankrupt Enterprises, *Fashi* [2012] No. 9, promulgated on 26 June 2012, effective on 12 July 2012.

³⁹ For example, SPC, Telephone Reply on the Statutes of Limitations in Tax Disputes, promulgated and effective on 27 December 1990.

⁴⁰ For example, SPC, Interpretation on Some Issues Concerning the Specific Application of Laws in the Trial of Criminal Cases of Tax Evasion and Resistance to Pay Tax, *Fashi* [2002] No. 33, promulgated on 5 November 2002, effective on 7 November 2002; SPC, Interpretations on Certain Issues Relating the Application of the Decision of the SCNPC on Punishments for the Crime of Falsely Writing, Forging or Illegally Selling Value-added Tax Invoices, *Fafa* [1996] No. 30, promulgated on 17 October 1996.

⁴¹ According to Art 45 of the Law on Administration of the Tax Collection, unless otherwise provided, tax levied by tax authorities shall have priority over unsecured creditors' claims. If a defaulting taxpayer is fined or is subject to confiscation for his illegal income, tax payment shall take priority over the fine and confiscation. Likewise, under Art 113 of the Law on Company Bankruptcy, tax payment precedes the ordinary creditor's claims in the compensation order.

⁴² SPC, Official Reply on Whether to Accept the Lawsuits Lodged by Tax Authorities to Determine their Creditor's Rights to the Late Fees of Tax Arrears Incurred by Bankrupt Enterprises, *Fashi* [2012] No. 9, promulgated on 26 June 2012, effective on 12 July 2012.

⁴³ For the late payment fee arising after the bankruptcy case accepted by the court, the opinion in *Fashi* [2012] No. 9 echoed the provisions in an earlier SPC rules. Under Art 61(2) of *Fashi* [2002] No. 23, it is provided that the late payment fee borne by the bankrupt company after the court accepted the bankruptcy case does not fall under the bankruptcy claims. See SPC, Provisions on Issues Concerning the Hearing of Enterprise Bankruptcy Cases, *Fashi* [2002] No. 23, Art 61(2), promulgated on 30 July 2002, effective on 1 September 2002.

payment”.⁴⁴ However, the SAT, in an official reply to the Guangdong State Tax Bureau issued in 2008 (*Guoshuihan* [2008] No. 1084),⁴⁵ held that the overdue payment fee, which is different from “fines”, shall be treated equally as the “tax payment” and given a compensation priority. While the interpretations of the SPC and the SAT are both in effect, it adds further confusion to taxpayers concerning which rules shall be followed. For tax authorities, unless the case was brought to the court proceedings, it is predictable that they would have the natural inclination to follow the SAT’s interpretative rules in tax administration.

This kind of conflict is unresolved under the current law. In China, the courts, including the SPC, cannot exercise judicial review over the administrative law or the abstract administrative behaviour utilized in making regulations or decisions. When the courts find an administrative rule inconsistent with the higher laws, what they can do is to submit such a questionable administrative rule to the SPC which *may* in turn refer the case to the State Council.⁴⁶ It is the State Council which has the final say on the legality of administrative interpretation. While the inconsistency or *ultra vires* of tax administrative rules was claimed by scholars to be a serious problem plaguing tax legislation in China,⁴⁷ there seems to be no precedent where the SPC has ever brought a tax administrative rule to the State Council for review. Although the SPC can deliver its interpretation of legal norms, such interpretation is confined to the sphere concerning the judicial ruling. The lack of supremacy of judicial interpretation over administrative interpretation ultimately leads to conflicts and disharmony within the legal system.

2. Courts’ Interpretation in the Adjudication of Tax Cases

On the whole, the administrative litigation regime in China remains weak due to various context-specific factors.⁴⁸ Problems seem to be more acute

⁴⁴ For the rationale of the SPC in making *Fashi* [2012] No. 9, see Sun Youhai *et al.*, “Understanding and Application of the SPC’s Reply on Whether to Accept the Lawsuits Lodged by Tax Authorities to Determine their Creditor’s Rights to the Late Fees of Tax Arrears Incurred by Bankrupt Enterprises” (in Chinese) (2012) 19 *People’s Judicature* 34.

⁴⁵ SAT, Reply to Whether Tax Compensation Priority Includes Fines, *Guoshuihan* [2008] No. 1084, promulgated on 31 December 2008.

⁴⁶ Article 53(2), Law of Administrative Litigation; Art 86, Law of Legislation.

⁴⁷ See Zhang Xuebo, “Research on Legitimacy of Tax Administrative Document” (in Chinese) (2008) 10 *Journal of South East University of Political Science and Law* 34; Yan Zhiyong, “Theoretical Study on the Application of Tax Law” (in Chinese) (2004) 4 *Finance and Tax Law Review* 264–268.

⁴⁸ These factors, which have been widely discussed in literatures, includes the interference from the Party and government officials, inter-court and intra-court influence, judicial corruption, a low level of legal consciousness among government officials and the citizenry, and the fragmentation and overlapping of authority that have resulted from the transition to a more market-oriented economy. See eg Veron Mei-Ying Hung, “China’s WTO Commitment on Independent Judicial

with respect to tax litigation. The following discussion aims to review factors that hamper the courts from contributing to the interpretation of tax law.

According to China's Statistic Yearbooks, from 1998 to 2011, the total number of tax cases in China was 13,419 (see Table 1). At the turn of the century, there was a notable increase in tax litigation which was soon followed by a steady decrease in the last decade. As the number of courts at all levels in China is around 3500,⁴⁹ the number of tax disputes brought to the courts in the year of 2011 is only 405 which implies that almost 90 per cent of all courts in China did not receive a single tax dispute in the whole year. Moreover, as the administrative cases in 2011 (at the number of 136,353) account for 1.8 per cent of all first-instance cases accepted by courts (at the number of 7,596,116) in China, the percentage of tax cases among administrative cases is almost negligible, ie less than 0.3 per cent. Tax litigation involving foreign investors from cross-border transactions was even rarer. To the author's knowledge, there have been only two reported cases adjudicated by the courts involving the application of tax treaties in the past three decades since China concluded its first comprehensive tax treaty on income and capital in 1983.⁵⁰ Like most administrative litigation in China, more than a half of tax litigations were settled in some way as taxpayers withdrew the lawsuits. For those cases where the courts made adjudications, the majority centre on the tax procedures rather than the substantive rules.⁵¹

All these facts are difficult to reconcile, *prima facie*, with another set of facts: from 1994 to 2012, tax revenue in China continued to grow at

Review: Impact on legal and Political Reform" (2004) 52(77) *American Journal of Comparative Law* 82–96; Randall Peerenboom, "Globalization, Path Dependency and the Limits of Law: Administrative Law Reform and Rule of Law in the People's Republic of China" (2001) 19 *Berkeley Journal of International Law* 164–178.

⁴⁹ See the website of the Supreme People's Court, available at <http://www.court.gov.cn/jgsz/rmfyj/j/> (visited 22 July 2013).

⁵⁰ China concluded its first tax treaty on income and capital with Japan in 1983. In the past 30 years, China's treaty has exponentially expanded to include 99 tax treaties and two tax arrangements with Hong Kong and Macau. In spite of the broad treaty network, there are only two cases that have been reported involving the tax treaty interpretation: *PanAmSat* (2002) and *Weihai* (2010). See *PanAmSat International Systems, Inc v Second Department in the External Substation of the Beijing State Tax Bureau*, decided by the Higher People's Court of Beijing on 20 December 2002. The verdict of the *Weihai* case is not publicly assessable, although the details of the disputes are disclosed in a SAT's circular titled "International Transport Cases Involved in the Implementation of Tax Treaties by the Office of the State Administration of Taxation in Shandong Province", *Guoshuibanfa* [2011] No. 34, 21 March 2011.

⁵¹ He Yan, "Administrative Interpretation of Tax Law in China: Status Quo and the Development" (in Chinese) (2011) 5 *Journal of Heilongjiang Administrative Cadre Institute of Politics and Law* 78.

Table 1 Administrative adjudication in the first trial (1998–2011)⁵²

Year	Cases accepted	Cases settled ⁵³	Different approaches tax cases were settled					
			Affirmation of administrative decisions	Revocation of administrative ruling	Dismissal of the lawsuit	Withdrawal of the lawsuit	Administrative compensation	Others
2011	405	399	21	9	25	225	0	29
2010	398	402	31	14	26	245	2	84
2009	293	343	56	13	30	161	0	83
2008	334	286	61	17	33	115	1	59
2007	306	310	73	12	42	108	2	73
2006	359	356	41	27	34	173	1	80
2005	828	815	69	26	107	572	8	46
2004	1032	1041	124	70	88	338	5	416
2003	803	816	126	60	90	225	3	312
2002	1496	1482	91	73	125	733	7	453
2001	1237	1270	159	71	147	515	82	296
2000	2055	2025	157	183	164	1200	54	267
1999	1804	1930	273	195	135	1150	129	48
1998	2069	1939	96	123	140	1466	33	81
Total	13419	13414	1378	893	1186	7226	327	2327

a startling rate of 18 per cent which is faster than the growth of GDP.⁵⁴ After the implementation of the uniform EITL, the income tax revenue derived from the non-resident companies increased from RMB 38.4 billion (around USD 6.3 billion) in 2008 to RMB 117 billion (around USD 18.8 billion) in 2013.⁵⁵ In the area of combating avoidance, tax authorities have become more aggressive than before. In the year of 2013,

⁵² The statistic in this table for the years is based on *China's Statistic Book* from 1998 and 2011. The statistics on the tax-related administrative cases before the year of 1998 was not recorded in the *Statistic Books*.

⁵³ The number of cases settled in 1 year may include cases that had been accepted before that year.

⁵⁴ B Brys (n 28 above), pp 3–5.

⁵⁵ The statistic derives from the *China's Tax Year Book* (in Chinese).

the tax revenue collected from anti-avoidance operations amounted to RMB 46.9 billion (around USD 7.6 billion), representing a year-on-year growth of 36 per cent over 2012 and almost a hundred times the revenue from the combat of avoidance in 2005.⁵⁶ Against this setting, how can the shrinking number of litigated tax cases be properly explained?

This study argues that litigation is an unfavourable dispute resolution mechanism for taxpayers in China due to cultural barriers, legislative obstacles and institutional hindrance. It ultimately leads to the result that the courts largely fail to have any serious impact on the development of the tax law regime through any systematic case-by-case interpretation method.

a. Cultural barriers

The first tax case in China occurred in Henan Province in 1988. A taxpayer claimed that the tax authorities' decision concerning the identification of taxpayers was wrong.⁵⁷ The appellate court upheld the taxpayer's claim and the verdict was published in the SPC's gazette. This case is said to have had an explosive impact on the tax administration nationwide, which prompted the promulgation of the administrative review regulation in October 1989 with the intent to avoid another defeat of tax agencies in judicial proceedings.⁵⁸

The thinking that "losing in litigation is losing face" persists till today in the minds of many governmental officials. This notion can be traced to the Chinese legal tradition under the impacts of Confucianism. According to Confucian teaching, the harmonious society can be achieved if every Chinese person fulfils the duties assigned to him according to his social status. Civilians shall be (unconditionally) submissive to the governors. The governors, who usually take on multiple roles as a judge, a tax collector, a decree-maker and a general administrator, shall protect and take good care of the citizens like the father to the son. It is "obligations", instead of "rights", that are the basis to construct the relationship between the governors and the citizens.⁵⁹ The stability of the social order has been

⁵⁶ Zhao Qian, "SAT: the Revenue from Anti-avoidance Operation Amounted to RMB 46.9 Billion Last Year" (in Chinese), *Economic Information Daily*, 19 March 2014, available at http://www.jjckb.cn/2014-03/19/content_496062.htm.

⁵⁷ This case took place even before the enactment of the Law on Administrative Litigation in 1990. See NPC, Law on Administrative Litigation, promulgated on 4 April 1989 and came into effect as of 1 October 1990.

⁵⁸ Shi Xuecheng, "Resolution Mechanism on Tax Administrative Dispute" (in Chinese), PhD dissertation submitted to Southwestern University of Finance and Economics in 2010, available at <http://www.cnki.com.cn>.

⁵⁹ See William C. Jones, "Trying to Understand the Current Chinese Legal System", in C Stephen Hsu (ed), *Understanding China's Legal System: Essays in Honor of Jerome A. Cohen* (New York University Press, 2003) 7–46; Mo Zhang, "The Socialist Legal System with Chinese Characteristics: China's Discourse for the Rule of Law and a Bitter Experience" (2010) 24 *Temple International & Comparative Law Journal* 1–64.

maintained by three pillars which are equally important, ie *Qing* (human feelings), *Li* (natural justice)⁶⁰ and *Fa* (statutory rules).⁶¹ If a governor fails to fulfil his role, it is very likely that he would first face a challenge from moral accusation (*Qing* and *Li*) instead of the risk of the legal responsibility (*Fa*).

Against this background, the core values which underpin the establishment of administrative litigation in the developed western countries are largely missing in China. Such values include the respect for private rights, checks and balances on public powers and the belief in the rule of law.⁶² Despite the visible development of a “rule of law” concept in China in the past decades, the influence of this Chinese cultural heritage can be commonly found in tax practice. For example, under the impact of the notion of “respecting officials as teachers” (*yi li wei shi*),⁶³ taxpayers and tax lawyers tend to consult tax authorities before drafting the tax planning schemes or to seek clarifications on a specific tax term. When disputes arise, taxpayers prefer to settle problems with tax authorities in a private and negotiable manner to maintain the long-term, cooperative relationship, instead of “tearing down the face” and fighting for the temporary victory in court. For tax officials, the “anti-litigation” emotion exists since the internal evaluation of their working performance will be negatively affected if the officials’ administration decisions are challenged in courts.⁶⁴ In the small likelihood that a tax dispute becomes the subject of court proceedings, judges are inclined to avoid adjudication and facilitate the reconciliation through mediation or other informal processes. When judges are interpreting the law, the rules spelled out by the tax administration, even though in an informal way and subject to questions on the legality, are given more weight than they deserve.

b. Legislative obstacles

Under the existing administrative litigation law, the scope that falls within the court’s jurisdiction is very narrow and limited to the examination of the *validity of specific administrative conduct*.⁶⁵ This has two implications: first, the

⁶⁰ *Li* (理) is a concept found in Neo-Confucian Chinese philosophy. It refers to the underlying reasoning and order of nature as reflected in its organic forms.

⁶¹ Ji Weidong (n 33 above), p 206.

⁶² Yang Haikun and Zhu Zhongyi, “Investigation into the Stagnancy of the Administrative Litigation” (in Chinese) (1999) 4 *Administrative Law Review* 72.

⁶³ According to the historical record, the notion of “respecting officials as teachers” was first raised by Li Si (280 BC–208 BC), the influential prime minister of Qin Dynasty and the representative of the legalist.

⁶⁴ The author obtained this information from the conversations with tax officials in Fuzhou and Xiamen.

⁶⁵ According to Art 2 of the Administrative Litigation Law, where citizens and legal persons or other organizations which consider the specific acts of administrative authorities or their personnel have infringed their lawful interests, they have the right to bring the litigation to the court.

courts cannot hear cases brought by citizens against “abstract administrative conduct”, namely the creation of administrative rules, regulations, decisions or orders with general binding force formulated and announced by administrative organs.⁶⁶ When the court finds a tax rule invalid or ambiguous, it can either ignore it in the application of law in a specific case or report it to the SPC which may refer the matter to the State Council. But the court cannot invalidate it nor make an interpretation.⁶⁷ As a result, even if certain administrative conduct based on a tax regulation that was perceived by the court as invalid was rescinded, this tax regulation may remain in effect and continue to apply. In practice, it is quite commonplace that the courts make direct reference to administrative rules – even with a low and questionable legal status – in an adjudication without examining the legality of such rules.⁶⁸ The *prima facie* harmony between administrative organs and courts is achieved by the latter voluntarily giving up their own limited discretion in reviewing or even challenging such administrative rules.

Second, it is the validity, rather than the reasonableness, of specific administrative conduct that may come under review by the court.⁶⁹ As tax legislation in China is often drafted in a rather brief form using broad language, tax authorities have wide discretion in the implementation of tax rules. As a result, a wide range of tax administrative conduct, even if in breach of the principles of proportionality, appropriateness or necessity, as long as it is not illegitimate, cannot be corrected in judicial proceedings. In other words, only conduct which is quite clearly *ultra vires* can be corrected.

The other legislative obstacle was created by the Law on the Administration of Tax Collection. Under Art 88 of this Law, for tax disputes⁷⁰ other than those arising from sanction decisions or

⁶⁶ See eg Art 12 of Administrative Litigation Law; Art 3, SPC, Interpretations of Certain Issues in the Implementation of the Administrative Litigation Law, *Fashi* [2000] No. 8, promulgated on 8 March 2000, effective on 10 March 2000.

⁶⁷ Article 53(2), Law on the Administrative Litigation.

⁶⁸ The existing law provides the basis for the courts to make reference to the rules and regulations promulgated by ministries of the State Council. However, the precondition is that such rules and regulations are valid and formulated in accordance with the higher law. See Art 53(1) of Law on the Administrative Litigation; Art 62(2), SPC, *Fashi* [2000] No. 8. The observation that, in practice, courts often do not review the legality of the administrative rules before making reference, is supported by a judge who once worked at the SPC; see Huang Songyou, “Power of Judicial Interpretation: Logic and Construction” (in Chinese) (2005) 2 *China Legal Science* 10.

⁶⁹ According to Art 56 of *Fashi* [2008] No. 8, when the plaintiff brought to the court specific administrative conduct which is legitimate but subject to the question of the reasonableness, the court shall reject the lawsuit.

⁷⁰ According to Art 100 of the Implementation Rules of the Law on the Administration of Tax Collection, the “dispute over tax payment” (*nashuizhengyi*) as mentioned in Art 88 of the Law on the Administration of Tax Collection refers to the dispute arising from the taxpayer, tax withholding agent or tax payment guarantor over such specific administrative acts by tax authorities as determining the subject of tax payment, target of tax collection, scope of tax collection, tax reduction and exemption, tax refund, applicable tax rate, base of tax assessment, stages of tax payment, period and place of tax payment and means of tax levying.

enforcement measures of tax authorities, taxpayers are required to fulfil two conditions before launching any litigation: first, pay or remit the tax and the overdue fine according to the decision made by the tax authority, or provide the corresponding guaranty; and then, go through the procedures of administrative review. It is only when the taxpayers disagree with the decision of the administrative review panel that the judicial remedies become available.⁷¹ This arrangement makes the journey of taxpayers to pursue judicial remedies not only long and thorny, but also economically costly. If taxpayers have the alternative to negotiate a reduced tax payment with tax authorities, they would rather not initiate judicial proceedings.⁷²

There are some noteworthy legislative movements. On 7 June 2013, the State Council released on its website a revised draft on the Law on the Administration of Tax Collection for public comment.⁷³ On 23 December 2013, a revised draft of the Law on Administrative Litigation was submitted to the SCNPC in the sixth meeting for deliberation. One of the key issues under discussion is to enlarge the scope of the courts' jurisdiction on administrative cases.⁷⁴ Will this ongoing movement clear up the legislative obstacles in the way of courts to be actively involved in the resolution of tax disputes? The answer is "yes and no". The "yes" stems from the optimistic hope that the coming reform in the administration litigation regime may unleash the initiative of judges and enhance the courts' independence in the exercise of judicial review of administrative conduct. The "no" is based on the reality that Art 88 of the Law on the Administration of Tax Collection, despite the severe criticism it has received, remains almost intact in the revised draft. A cloud of uncertainties still remains with the revision of these two laws. It will take time to see the impact of these legislative changes on tax litigation.

⁷¹ The rationale to make the administrative review a prerequisite for judicial proceedings is based on the assumptions that tax authorities would be at a better position to evaluate the tax-related administrative acts. It is conducive to the continuity and uniformity of decision-making process by tax authorities, whereas the caseload of the court can be effectively reduced. See Gu Guoxian, "Reflection and Perfection of the Existing Tax Litigation Mechanism" (in Chinese) (2006) 11(2) *Journal of Taxation College of Yangzhou University* 37; Wang Hongmao, "An Analysis on the Defect in China's Tax Administrative Procedural System" (in Chinese) (2009) 290(7) *Taxation Research* 45.

⁷² See Wei Cui, "What is 'Law' in Chinese Tax Administration" (2011) 19(1) *Asia Pacific Law Review* 86.

⁷³ The draft version of revised Law (24 Aug 2013), available at <http://www.chinalaw.gov.cn/article/cazjgg/201306/20130600387820.shtml> (visited 24 Aug 2013). The deadline for the public solicitation is July 2013.

⁷⁴ Sun Ying, "China Launched the Revision of the Law on Administrative Litigation" (23 December 2013), available at <http://www.chinanews.com/fz/2013/12-23/5649507.shtml> (visited 13 Jan 2014).

c. *Institutional hindrance*

“Are judges in China competent to adjudicate tax cases?” This is a common concern among taxpayers, tax practitioners, tax authorities and tax law educators in China.⁷⁵ In the countries where there are special tax courts, judges admitted to tax courts normally have tax expertise acquired from prior practice experience, government service or a combination of both. Their experience, either representing taxpayers in tax planning as well as tax controversies or serving at public organs in drafting tax policy and participating in litigation, enables them to take an objective and independent view of the issues to be decided.⁷⁶

This is not the case in China. Since there is no specialized tax court, the disputes that taxpayers launch against tax authorities are brought to the administrative chambers (*xingzheng shenpan ting*) of the court. Judges at courts are normally required to pass the civil service test and the bar examination. Neither of these examinations gives any consideration to tax expertise or knowledge of the candidates. In the law schools of universities which send thousands of graduates to the court system, the courses on tax law have been, in the long term, placed in a marginal position in the curriculum and are offered as optional courses. It is thus not a surprise that there is a severe lack of tax knowledge and expertise among judges. The ramifications of that are imaginable: judges who are uncertain of their competence in handling tax issues are inclined to take the opinions of tax authorities as authoritative, and in some extreme cases, even consult tax authorities at a higher level for suggestions before making decisions. The discretion of courts granted by the law to review the validity of the regulations issued by the SAT and the MoF only exists in name and has rarely been exercised. Even if occasionally judges render opinions on a certain provision of tax law, their interpretations more often invite criticism and questioning from tax professionals, rather than affirmation.⁷⁷ To play safe, many of the verdicts in tax cases are written in an extremely brief and concise manner in which the deductive process and the logical analysis are left unstated, and the application of the law is reduced to the mere mention of the name of the law and

⁷⁵ See eg Li Jin, “Teaching Taxation Law in China” (2008) 62(5) *Bulletin for International Taxation* 183–190.

⁷⁶ David Laro, “The Evolution of the Tax Court as an Independent Tribunal” (1995) 1(17) *University of Illinois Law Review* 24.

⁷⁷ For instance, in the *PanAmSat* case in which the Beijing High People’s Court disregarded two SAT informal rules regarding the characterization of income arising from the lease of satellites and directly applied the tax statute and the tax treaty as the legal basis, tax scholars raise questions concerning the way the Court interpreted the US–China tax treaty. See eg Chen Yanzhong, *Interpretation Issues of International Tax Treaties: A Preliminary Study* (in Chinese) (Beijing: Science Press, 2010) 4.

the provisions.⁷⁸ In the author's opinion, this lack of tax competence in judges in handling tax disputes is one of the most fundamental causes leading to the reduction of judicial impacts in the tax arena.

V. Administrative Interpretation: The Leading Force in Tax Law Interpretation and Policy Development

In China, the administrative interpretation in tax law is carried out by the State Council and four of its ministries, namely the SAT, the MoF, the General Administration of Customs (GAC)⁷⁹ and the Customs Tariff Policy Commission (CTPC).⁸⁰ As the GAC and the CTPC are specifically responsible for the formulation and development of tax rules on customs, the SAT and the MoF take the responsibilities to interpret a wide range of tax laws except for customs.

1. State Council's Interpretation on Tax Law

There are two ways that the State Council interprets tax law. First, it promulgates implementation rules of tax statutes to set out detailed operational rules. Given the scarcity of the existing tax statutes as well as their excessive generality and vagueness in content, these implementation rules are often an extension of legislative activities, rather than mere interpretation. Next, the State Council also interprets administration regulations issued by it when clarification or supplementary provisions to such regulations are needed, or when ministries or governments at the provincial level encounter difficulties in giving interpretations or bring up different interpretations during the course of application.⁸¹ In practice, the interpretation falling under the latter category is very rare.⁸²

⁷⁸ In dozens of tax judgments the author has read, most of them follow a monotonous pattern which did not elaborate on the rational in the application of the law. The understatement of verdicts is a common problem that exists in China's judicial system. See Wei Shengqiang, "Some Thoughts on the Improvement of China's Court Decisions" (in Chinese) (2012) 5 *Science of Law* 75.

⁷⁹ The GAC is at the same level as the SAT and MoF in terms of legislative power. It is responsible for studying and drafting regulations on customs administration and the detailed rules for the implementation for such regulations.

⁸⁰ For the powers of the Customs Tariff Commission on the law interpretation, the following notice from the State Council provides the description: Power of the Customs Tariff Commission of the State Council to Interpret the Regulation of on Import and Export Duties, *Shuiweihui* [2004] No. 10, 5 July 2004.

⁸¹ General office of State Council, Notice on the Power and Procedures on the Interpretation of Administrative Regulations, *Guobanfa* [1999] No. 43, 10 May 1999.

⁸² One example is *Guobanhan* [2004] No. 23 in which the general office of the State Council responded to the SAT's inquiry concerning the interpretation of the term "collection and management" in Art 5 under the Interim Regulations on the Urban Maintenance and Construction Tax.

2. *Highly Centralized Powers of SAT and MoF to Interpret Tax Law and Relevant Problems*

Given the limited participation of the State Council, the predominant task to interpret tax law actually falls upon the shoulders of two ministries, the SAT and the MoF. They are in charge of drafting tax statutes and implementation rules, providing ministerial regulations on tax issues and giving interpretation to the existing tax law. In the absence of effective legislative guidance and judicial checks, the high centralization of powers with the SAT and the MoF to legislate, interpret and administer tax law is very likely to lead to arbitrariness and disorder in the rule-making. Problems can be manifested in multiple ways:

- (1) the interpretative work undertaken by the SAT and/or the MoF is so closely interwoven with the legislative powers that the line between the two is blurred;
- (2) *ultra vires* or inconsistent interpretations that deprive taxpayers of rights under the higher law are rampant;
- (3) retrospective application of these informal rules and flaws in the formality add further doubts about the legal effect of such rules and
- (4) ultimately, taxpayers are put at a vulnerable and disadvantageous position facing the frequent and non-transparent changes of tax rules without effective channels to challenge the legality of such rules.

The interpretation of anti-avoidance rules in the EITL is an example to illustrate these problems. The EITL is one of the four tax statutes passed by the legislature in China, and the anti-avoidance rules are provided in Chapter 6 (Arts 41–48), namely “the special tax adjustment”. These eight provisions, no more than a half page in length, lay down the skeleton of the anti-avoidance rules, whereas the flesh is filled in by the Implementation Rules of the EITL promulgated by the State Council together with a collection of rules issued by the SAT (or jointly with the MoF). The list of the SAT rules with an anti-avoidance function is expansive and open ended.⁸³ Very often, these SAT rules go far beyond mere interpretation, and set down the basic rules which materially affect

⁸³ For example, SAT, Circular on the Implementing Measures for Special Tax Adjustments (Trial Implementation), *Guoshuifa* [2009] No. 2, promulgated on 8 January 2009, effective on 1 January 2008; SAT, Notice on the Internal Implementation Regulations on Special Tax Adjustments, *Guoshuifa* [2012] No. 13, promulgated on 10 February 2012, effective on 1 March 2012; SAT, Notice on the Procedural Guidelines for Joint Review of Significant Special Tax Adjustments Cases (Trial), *Guoshuifa* [2012] No. 16, promulgated on 16 February 2012, effective on 1 March 2012.

taxpayers' rights and obligations. Certain anti-avoidance articles of the EITL would have been non-implementable without the SAT rules.⁸⁴ Some of the SAT rules were promulgated with retrospective effect.⁸⁵ On other occasions, the SAT took a bold leap to go beyond the literal meaning of the articles in the EITL, and expanded tax jurisdiction to capture revenue which has an "indirect link" with China.⁸⁶ While the meaning of "lack of reasonable business objective" under the general anti-avoidance rule (GAAR) in Art 47 of the EITL is ambiguous,⁸⁷ in practice, tax agencies tend to take a simplistic approach to equate this expression with the fact that a taxpayer derives tax benefits. The question of whether the primary purpose of the transactions is really tax oriented or just tax related is too often disregarded by tax agencies. Due to the lack of involvement of a neutral third party like courts, in some situations, taxpayers have to compromise and accept decisions made by tax authorities based on various considerations.

3. Reform on the Way

A reform has begun, not in any radical way, but using a progressive and piecemeal approach to bring gradual and visible adjustments to the existing tax system. This reform has taken place within the wider setting of the restructure of the administrative law in China at the turn of the century

⁸⁴ For example, Circular No. 121 [2008] provides the fixed ratio on the deductible interest under thin capitalization rules. See SAT and MoF, Circular on Tax Policy Issues Relating to Deduction of Interest Paid by Enterprises to Affiliated Parties, *Caishui* [2008] No. 121, promulgated and effective on 23 September 2008.

⁸⁵ For instance, Art 10 of Circular [2009] No. 59 is a provision with the anti-avoidance function which allows tax authorities to treat transactions involving assets or equities within 12 months before or after a reorganization as a single transaction based on the "substance over form" principle. This circular has a retrospective application effect. See MoF and SAT, Notice on Enterprise Income Tax Treatment of Enterprise Reorganizations, *Caishui* [2009] No. 59, promulgated on 30 April 2009, effective on 1 January 2008.

⁸⁶ For example, Arts 5 and 6 of Circular [2009] No. 698 provides that capital gains derived by a non-resident company from indirect disposition of shares in Chinese companies may be taxed in China if the intermediary company has no business substance and can be "looked through". These provisions are in conflict with the sourcing rules in the Implementation Rules of ETIL (Art 7), which provides the capital gains from the disposition of shares are sourced in the country where the investee company is. See SAT, Tax Issues for Equity Transfers by Non-China Tax Resident Enterprises, Circular [2009] No. 698, promulgated on 15 December 2009, effective on 1 January 2008.

⁸⁷ Under the GAAR (Art 47) of the ETIL, when the companies arrange transactions without reasonable business objectives to reduce taxable income, tax agencies are entitled to make readjustments in a reasonable manner. But as to what constitutes the "lack of reasonable business objectives", the existing rules have not elaborated. In the para 39 of SAT Circular [2008] No. 159, three elements are provided to identify a transaction "for lacking the reasonable commercial purpose", namely an artificial scheme, tax benefits and the primary purpose of the transaction to reap tax benefits. But the meaning for each element is still unclear. According to Art 120 of the Implementation Rules to the ETIL, "lack of reasonable business objectives" is generally described as taxpayers having a primary purpose to reduce, waive or postpone tax payments.

which was driven by a combination of objectives: the needs of the market economy, the integration into the globalized world and the pursuit of the rule of law. The hallmark of this administrative law overhaul is the decision promulgated by the State Council in 1999 entitled the “Comprehensive Promotion of the Administration in Accordance with Law”.⁸⁸ In the following decade, the State Council provided a series of regulations, policy statements and implementation outlines to translate the abstract notion of “administration in accordance with law” into concrete measures and actions. These include regulating procedures on the enactment of administrative regulations and rules, establishing the review system to check the legitimacy of existing administrative regulations and rules, designing rules to curb the arbitrary use of administrative discretion, providing channels for the governmental information access and building up the accountability system for officials.⁸⁹ A general theme under this movement is to rein in the bureaucracy and give more weight to the protection of individual rights.

The SAT, following the lead of the State Council, brought the reform to the tax area. This reform has been carried out from top to bottom in tax administration system since 2000. It was accelerated in recent years as the SAT has increased the pace to bring forward new regulations, rules or internal documents on tax procedural rules and to make frequent revisions on the old rules. The efforts made by the SAT and its accomplishments are rather impressive. They include the following examples (2009–2014):

- (1) In SAT Order [2010] No. 20,⁹⁰ the new measure on the enactment of tax normative rules was promulgated in the form of ministerial regulation. It requires public solicitation and transparency in the formulation of tax rules, reinforces the general principle of non-retrospective application and introduces a review mechanism on the legitimacy of existing rules.
- (2) Based on SAT Order [2010] No. 21,⁹¹ the regulation on tax administrative review was systematically revised. It provides

⁸⁸ State Council, Comprehensive Promotion of the Administration in accordance with Law, promulgated on 15 March 1999. This official document was issued to echo the amendment of the Constitution in March 1999 which provides in Art 5 that China shall pursue the administration in accordance with law.

⁸⁹ See Shen Kui, “Administrative Self-regulation and Rule of Administrative Law: A Preliminary Investigation” (2011) 3 *Administrative Law Research* 34–37.

⁹⁰ This new measure was issued to replace its predecessor, *Guoshuifa* [2005] No. 201 which was in the form of informal tax rules. For comparison, see SAT, Administrative Measures for Formulating Normative Documents in Taxation (for Trial Implementation), *Guoshuifa* [2005] No. 201, effective on 1 March 2006 and repealed on 1 July 2010; SAT, the Administrative Measures for Formulating Normative Documents in Taxation, Order No. 20, promulgated on 10 February 2010 and effective on 1 July 2010.

⁹¹ SAT, Rules on Taxation Administrative Review, Order No. 21, promulgated on 10 February 2010 and effective on 1 April 2010.

more sophisticated rules on evidence, grants taxpayers broader access to participate in the review proceedings and strengthens supervision of the conduct of tax authorities. In October 2012, the administrative review panel of the SAT was established. This panel can participate in the review proceedings and provide suggestion for settlement when the cases involve major and difficult tax issues. One third of the panel (8/24) is comprised of tax professionals from academia, accounting firms and law firms.⁹²

- (3) *Guoshuifa* [2012] No. 92⁹³ provides new rules to standardize the usage of titles and formats in tax official documents.
- (4) *Guoshuifa* [2012] No. 65⁹⁴ provides instructions to curb the abusive use of administrative discretion.
- (5) In February 2014, the SAT issued a notice which mandates public solicitation as a prerequisite step before the promulgation of ministerial regulations and tax normative rules.⁹⁵
- (6) Quite a few regulations have been issued from 2009 to 2013 on the protection of taxpayers' interest and redefining the role of tax administration as a service-oriented organ. These regulations aim to strike a balance between governmental efficiency and respect for individual rights.⁹⁶

Against this setting, the rules on how the tax administration should interpret the tax law are gradually taking shape. In general, the SAT's interpretive powers are exercised in two scenarios: first, the SAT can interpret tax-related administrative regulations enacted by the State Council.⁹⁷ Alternatively, the SAT may interpret the tax normative rules enacted by it. The "normative rules", as defined in SAT Order [2010] No. 20, refer to those rules bearing the following three features: (1) being

⁹² For the composition of the panel, available at <http://www.chinatax.gov.cn/n8136506/n8136608/n9947993/n9948049/12159165.html> (visited 23 Dec 2013).

⁹³ SAT, Notice on the Standards of Official Documents in National Tax Administrative Organs, *Guoshuifa* [2012] No. 92, promulgated on 10 October 2012.

⁹⁴ SAT, Guidance on Regulating Tax Administrative Discretion, *Guoshuifa* [2012] No. 65, promulgated on 3 July 2012.

⁹⁵ SAT General Office, "The SAT Mandates the Public Solicitation as a Prerequisite Condition before the Promulgation of Tax Rules" (in Chinese) (28 February 2014), available at <http://www.chinatax.gov.cn/n2735/n2834/n2835/c664081/content.html> (visited 4 Mar 2014).

⁹⁶ See eg SAT, Bulletin on the Rights and Obligations of Taxpayers, *Bulletin* [2009] No. 1, promulgated on 6 November 2009; SAT, Several Opinions on Strengthening the Protection of Taxpayers' Rights, *Shuizongfa* [2013] No. 15, promulgated on 9 February 2013; SAT, Notice on the transition of the functions (of tax administration) and improvements of service, *Shuizongfa* [2013] No. 74, promulgated on 12 July 2013.

⁹⁷ General office of State Council, Notice on the Power and Procedures on the Interpretation of Administrative Regulations, *Guobanfa* [1999] No. 43, 10 May 1999.

made and promulgated by tax agencies at and above the county level; (2) which prescribe the rights and obligations of taxpayers, withholding agents and other parties against whom tax administrative actions may be taken and (3) which have general binding force and are applicable repeatedly within the jurisdiction of the tax agency.

The interpretation of the tax law made by the SAT is generally pronounced under three forms: bulletin (*gonggao*), opinion (*yijian*) and reply (*pifu*). The bulletin is applied to announce important or legal matters domestically and abroad on tax issues and shall be promulgated in public. The opinion is used to convey the opinions of tax authorities on important tax matters under the format of the letter (*han*). Both bulletins and opinions are normative rules and their enactment shall comply with the procedures under the SAT Order [2010] No. 20. Whenever a taxpayer finds the interpretation made by the SAT in the form of bulletin or opinion inconsistent with the superior laws, he may apply to the SAT to conduct a review on the legitimacy of such rules without entering into administrative review procedures or administrative litigation.⁹⁸ In contrast, the reply does not constitute a normative rule. It is used to address a specific inquiry from local tax authorities arising from a certain situation and theoretically has effect only in that particular case.⁹⁹

4. Interrelation Between the SAT and Local Tax Agencies on the Interpretation of Tax Law

After the 1994 fiscal reform, China established the bifurcated system of tax administration which included state tax bureaus (*guo shui*) and local tax bureaus (*di shui*). Local tax agencies, in this context, refer to state tax bureaus and local tax bureaus at the provincial, municipal and county levels. They are all subordinate to the tax policy and technical guidance set out by the SAT.

According to Art 20 of SAT Order [2010] No. 20, the power to interpret tax normative rules exclusively belongs to the agency which enacted the rules. In other words, local tax agencies cannot interpret rules enacted by the SAT but merely apply them. However, a practical issue arises: as the application and interpretation of the law are mostly intertwined, how can it be ensured that the work of local tax agencies is minimized to the mechanical use of the SAT rules, instead of producing “creative applications”? To address this concern, one of the ways adopted

⁹⁸ Article 35, SAT Order No. 20, 2010.

⁹⁹ See eg SAT Official Reply to Issues Concerning Levying of Land Appreciation Tax on Above-ground Structures, *Guoshuihan* [2010] No. 347, promulgated on 26 July 2010.

by the SAT to curtail the discretion of local tax agencies is to make the meaning of the rules more self-evident and easier to implement. Some practical strategies¹⁰⁰ have been used in this regard:

- (1) to illuminate the meaning of an undefined term or to add clarity to certain abstract concepts, the SAT tends to provide a list of factors so that tax authorities can complete an overall analysis based on the facts of each case;¹⁰¹
- (2) the rulings reported from local agencies are published by the SAT on a selective basis to indicate the endorsement from the top echelon and to serve as the examples for other agencies¹⁰² and
- (3) when tax rules are promulgated, the SAT issues the commentary simultaneously to explain the background and the aims of new rules as well as key points in the implementation.¹⁰³

In addition, local tax agencies are directed to consult the SAT for instructions and guidance (*qingshi*) whenever they encounter uncertainties and ambiguities in the application of the SAT rules in a specific scenario. The SAT may address the inquiry either in the form of an opinion,¹⁰⁴ which has general binding force and can be used repeatedly by tax agencies, or in the form of a reply,¹⁰⁵ which has effect only on that specific case. This mechanism of consultation for instructions is widely used by local tax agencies as a protective umbrella since, if the actions of tax agencies have been endorsed by the SAT, tax agencies can more easily

¹⁰⁰ These strategies are provided in the technical guidance the SAT sent out to local agents, see eg SAT, Guidance on Regulating Tax Administrative Discretion, *Guoshuifa* [2012] No. 65, promulgated on 3 July 2012; SAT, Several Opinions on Strengthening the Protection of Taxpayers' Rights, *Shuizongfa* [2013] No. 15, promulgated on 9 February 2013.

¹⁰¹ For instance, to clarify the meaning "beneficial ownership", in Circular [2009] No. 601, the SAT provided a list of seven adverse factors based on which the taxpayers may be denied as the beneficial owner of the income. See SAT, Notice on How to Understand and Determine the "Beneficial Owners" in Tax Treaties, Circular [2009] No. 601, promulgated and effective on 27 October 2009.

¹⁰² See eg SAT, Notice on Correctly Dealing with Treaty Abuse Case regarding the Xinjiang Anti-Treaty Shopping case, *Guoshuihan* [2008] No. 1076, promulgated on 30 December 2008; SAT, Notice on International Transport Cases Involved in the Implementation of Tax Treaties by the Office of the SAT in Shandong Province, *Guoshuibanfa* [2011] No. 34, promulgated on 21 March 2011.

¹⁰³ To some degree, these official commentaries may be construed as the legislative documents and supplementary materials to facilitate the understanding of tax rules. They formed an integral part for tax authorities to read and apply new tax rules.

¹⁰⁴ See eg SAT, Opinions on the Cases Involving Beneficial Ownership Raised by Hubei, Other Provinces and Cities concerning the Dividend Provision under the Tax Arrangement between the Mainland and Hong Kong, *Guoshuihan* [2013] No. 165, promulgated and effective on 12 April 2013.

¹⁰⁵ See eg SAT, Reply on Matters Relating to Wal-Mart's Acquisition of the Equity of Trust-Mart, *Shuizonghan* [2013] No. 82, promulgated and effective on 21 February 2013.

withstand any possible court challenge and be shielded from the official risks of making mistakes in their decisions.

Local tax agencies, however, are not puppets. Although the SAT has exerted increasing influence and supervision on local agencies regarding the application of tax law, there are vast areas out of its reach. The majority of tax rulings that are neither reported to the upper offices nor disclosed to the public are kept confidential between taxpayers and agencies. The non-transparency of the bargaining process, the complicated considerations on relationships and the “thin culture of legality” among tax officials cast serious doubt on whether local tax authorities indeed constrain the activities to the mere application of law. Such concerns are reinforced by reading some of the rulings reported in the press. These reported rulings are the one-sided stories told by agencies and published on the China Taxation News, an official newspaper run by the SAT. They usually contain a brief description of facts and a large body of text depicting actions taken by agencies to capture tax revenue. Meanwhile, the legal reasoning of the agency’s decision, the taxpayers’ propositions and the negotiation process are simply left out or played down. It occurs from time to time that the decisions of tax agencies clearly deviate from the literal meaning of tax rules or constitute the interpretative activities prohibited by the SAT rules.¹⁰⁶ Such problems can hardly be rectified unless the SAT takes notice and issues new circulars to give clarifications.

VI. Moving towards the Rule of Law in the Interpretation of Tax Law

The rule of law is generally considered to contain the following core elements: the government is bound by the law and not above it; laws are fairly and transparently made; laws are publicly and readily accessible without retrospective application and laws are generally acceptable to

¹⁰⁶ For example, Chongqing State Tax Bureau published one of its ruling made in 2011 which recharacterized a service payment paid from a Chinese company to a Hong Kong company as the dividends. In that case, the Hong Kong company provided service to the Chinese company for the development of the environmental protection project and took the responsibility to find potential overseas buyers for the Chinese company. Despite the fact that Hong Kong company did not hold any shares in the Chinese company, the Chongqing State Tax Bureau decided that the payment from the Chinese company to the Hong Kong company constitute dividends, rather than service income, since Hong Kong company shares the risk in this environment protection project. The recharacterization of income as such cannot find the explicit basis under the existing tax rules, except for the abstract doctrine of “substance over form”. See International Tax Administration of Chongqing State Tax Bureau, Case study of the CERs project (17 May 2013), available at <http://wenku.baidu.com/view/a788ec2cb4daa58da0114aab.html> (visited 17 May 2013); Alex Duan, “Income from Sale of Carbon Credits Is Taxable Dividend, Chinese Tax Authority Says”, *Taxanalysts: Worldwide Tax Daily*, 16 November 2011.

those to whom they apply.¹⁰⁷ Despite the positive signals drawn from the SAT's self-restraint in their legal interpretative activities, the main blocks hindering the implementation of the rule of law in the tax field still remain in place as the monopoly status of administrative organs to legislate, interpret and administer tax law has not been fundamentally changed. While the judiciary in China is and may continue to remain feeble in the tax field, this part identifies other possible routes by which the interpretation of tax law carried out by administrative organs can move closer to the basic requirements of the rule of law under the impact of external checks and supervision.

1. Restoration of Tax Legislative Powers to the Legislature

The high centralization of legislative and interpretative powers vested in administrative organs is the root cause of many problems in the interpretation of tax law, including *ultra vires* interpretations and inconsistencies among the rules. To address such problems, the first step is for the legislature to reclaim its tax legislative powers provided under the Law of Legislation. While this proposition has been called for in academia for a long time, the legislature did not take any public action until very recently. In March 2013, during the 12th Meeting of the NPC, a motion, initiated by a delegate from Shandong and gathering support of more than 30 delegates within a day, was submitted to the Legislative Affairs Commission of the NPC. It asked for the power of tax legislation, currently retained by the State Council, to be returned to the NPC and the SCNPC.¹⁰⁸ In early July 2013, the budgetary affairs commission of SCNPC made a preliminary official response to this motion, acknowledging the unsatisfactory status of tax legislation in China. This response, however, did not give a definite answer on whether the 1985 Directive – under which the sweeping delegation of tax legislative powers was made – will be terminated and how the interpretative power will be restored by the NPC.¹⁰⁹

At the third Plenum of the 18th Congress of the Chinese Communist Party (CCP) held in November 2013, the principle of “taxation according

¹⁰⁷ For the discussion of how the rule of law originated and has meant according to different theories, see Richard Cullen, *The Rule of Law in Hong Kong*, July 2005, available at http://civic-exchange.org/en/live/upload/files/200507_RuleofLaw.pdf (visited 9 Jan 2014).

¹⁰⁸ Li Qiaoyi, “NPC Proposal Aims to Challenge State Council Tax Powers” (9 March, 2013), available at <http://www.globaltimes.cn/content/766904.shtml#.UfHM4Y2nr6M> (visited 22 July 2013).

¹⁰⁹ Yin Liang, “The NPC Endorsed the Motion on the Reclamation of Tax Legislative Power by the NPC” (in Chinese), *Beijing Times*, 4 July 2013, available at <http://gb.cri.cn/42071/2013/07/04/2225s4169691.htm> (visited 22 July 2013).

to the law” (*shui shou fa ding*) appears, for the first time, in the report of the CCP which hammers out the country’s broad economic agenda for the next decade. It has been incorporated among the measures to improve the NPC mechanism.¹¹⁰ The essence of this principle, as widely recognized by scholars in China,¹¹¹ requires the government to levy tax based on laws passed by the legislature. In other words, citizens can refuse to pay tax if there is no explicit provision under the tax law. This sends a strong signal that the legislature in China will play a more active role in the tax field in the years to come, which can scale down the broad powers enjoyed by administrative organs to both legislate and interpret tax law.

2. Increasing Supervision from Civilians, Tax Professionals and Non-governmental Entities

There has been a general awakening of awareness among Chinese citizens on their “rights as taxpayers” in recent years. This has happened within the larger context as people in China are gaining an increasing consciousness of private property rights and seeking further protection of these rights.¹¹² It has also been affected by some particular events such as:

- (1) In 2009, China was ranked at the second place in Forbes Tax Misery Index which indicates that China is among countries with the heaviest tax burden in the world. It aroused a fierce discussion nationwide on the justification of taxation in China and the increasing demand for the transparency of the governments’ budget;
- (2) In 2007, a non-governmental organization called “Transition Research Institute” (*chuan zhi xing*) was established. One of their aims is to promote the awareness of taxpayers’ rights among civilians by publishing annual reports on tax matters in China that are publicly and freely downloadable;¹¹³

¹¹⁰ CPC Central Committee, Decision on Major Issues Concerning Comprehensively Deepening Reforms adopted at the Third Plenary Session of the 18th CPC Central Committee, issued on 12 November 2013.

¹¹¹ See eg Tan Youtu *et al.*, “The Theory of Taxing According to Law” (in Chinese), (2000) 3 *Modern Law Science* 76; Zhang Shouwen, “The Principle of Taxing According to Law” (in Chinese) (1996) 6 *Chinese Journal of Law* 34; Wang Hongmao, “Review on the Principle of Taxing According to Law” (in Chinese) (2004) 3 *Law Review* 56.

¹¹² Mo Zhang, “From Public to Private: The Newly Enacted Chinese Property Law and the Protection of Property Rights in China” (2008) 5 *Berkeley Bus. L.J.* 317, 322.

¹¹³ From 2007 to 2011, the Transition Institute published four reports and a book on taxpayers’ rights. These reports are given the sub-titles such as “the Truth of Taxation” (2007), “Say No to Plunder, Start from Tax” (2008), “Pursuing the Transparent Fiscal System” (2009), “Double Taxation” (2011). These reports written in Chinese can be downloaded at <http://www.zhuanxing.cn/html/tax/index.html> (visited 13 Jan 2014).

- (3) In May 2008, the Provision on the Publication of Governmental Information¹¹⁴ came into effect providing a legal basis for citizens to seek particular information from governments. Since then, some citizens have taken the initiative to ask governments to publicize financial budgets and a few of them received positive feedback.¹¹⁵

The growing civil society force exerts a noticeable impact on the interpretation of tax law made by administrative organs. In December 2009, 24 foundations collaborated to submit a letter to the State Council to request a review on the legality of two notices issued by the SAT and the MoF, namely *Caishui* [2009] No. 122 and *Caishui* [2009] No. 123.¹¹⁶ A pivotal issue was whether the interpretation of the term “qualified non-profit organizations (NPO)” under the EITL given by the MoF and the SAT was contrary to the EITL and its implementation rules.¹¹⁷ This event is noted as “one of the top ten events signalling the civilization development” in China in 2009. In February 2011, 13 tax professors from renowned universities submitted a jointly signed letter to the SCNPC questioning the legitimacy of the State Council’s decision to allow some cities to launch the house property tax reform. This decision was said to contradict with the existing provision of the real property tax.¹¹⁸ The supervision from outsiders on the interpretative activities of tax authorities is reinforced by the release of the SAT Order [2010] No. 20.

¹¹⁴ State Council, Provision on the Publication of Governmental Information, State Council Order No. 492, promulgated on 5 April 2007, effective on 1 May 2008.

¹¹⁵ For example, according to the stories told by Mr. Wu Junliang, a CEO of a private company in Shenzhen, he has submitted inquiries to the governments of different cities since 2007 asking for the publication of financial budgets. Only a few of them made positive replies. For instance, Shenzhen Municipal Government allowed Mr. Wu to read financial budgets of the year in 2008 in paper and Guangzhou Municipal Government published their local budgets on line. See <http://www.globalpeople.com.cn/index.php/news/society/3860> (visited 13 Jan 2014).

¹¹⁶ MoF and SAT, Notice on the Issues Concerning Tax-exempt Income of Non-profit Organizations With Respect to Enterprise Income Tax, *Caishui* [2009] No. 122, promulgated on 11 November 2009, effective on 1 January 2008; MoF and SAT, The Circular on Management Issues Concerning the Eligibility of Non-profitable Organization for Tax Exemption, *Caishui* [2009] No. 123, promulgated on 11 November 2009, effective on 1 January 2008. It is noted that *Caishui* [2009] No. 123 has been repealed by *Caishui* [2014] No. 13. Compared with *Caishui* [2009] No. 123, *Caishui* [2014] No. 13 enlarges the scope of “qualified non-profit organizations” by removing the condition that the major activities of the NPO shall be carried out in China. Other than that, the main context of *Caishui* [2009] No. 123 remains untouched. This minor change seemingly has not yet responded adequately to the opposition raised by these foundations. See MoF and SAT, The Circular on Management Issues Concerning the Eligibility of Non-profitable Organization for Tax Exemption, *Caishui* [2014] No. 13, promulgated on 29 January 2014, effective on 1 January 2013.

¹¹⁷ Xiong Wei, Zhu Yansheng, Yang Xiaoqiang, *et al.*, “The Meaning and Inspiration of the Questioning Raised by Taxpayers on the Legality of the Tax Normative Rules” (in Chinese) (2010) 1 *Tax Law and Case Review* 1–22.

¹¹⁸ For the participating professors and the main context of the letter (in Chinese), please see <http://www.citact-xmu.com/plugin.php?mid=2&hcid=13&id=3299> (visited 23 Nov 2013).

According to this order, when a taxpayer finds tax normative rules issued by tax authorities inconsistent with the higher laws, he may apply to the rule-enacting tax authority or tax authority at a higher level to conduct a review on the legitimacy of such rules without entering into administrative review procedures or administrative litigation.¹¹⁹ As one official of the MoF commented, previously tax reform in China was carried out simply based on an official document jointly drafted by the MoF and the SAT and approved by the State Council. There was little room for civilians to participate and voice their opinions. However, this does not and will not work well any longer. In the near future, the cost of “game playing” in China’s tax reform will increase.¹²⁰

3. *Complying with International Tax Norms*

Three decades ago, when the OECD and the UN laid down the two most influential models on tax treaties on income and capital providing templates for countries to follow in the conclusion of tax treaties, ie the OECD Model 1977 and the UN Model 1980, China just ended its chaos after the Cultural Revolution. At that time, the country was preoccupied by domestic reconstruction, seeking directions for economic development. The open-door policy, established in 1978 and implemented since then, gradually transformed China from being “an outsider” within the international tax community to being a more active and outspoken participant. Today, China has a broad treaty network in the tax field: tax treaties on income and capital with 99 countries, two tax arrangements with Macau and Hong Kong, tax information exchange agreements with 10 countries and a multilateral convention on tax administrative assistance.¹²¹ These treaties and arrangements have gained unprecedented significance today as a consequence of the rapidly growing volume of cross-border transactions in China’s economy.

Like domestic tax rules, the interpretation of tax treaties is rarely subject to review by the judiciary. The formulation of treaty interpretative rules mainly relies on the SAT. In the past 30 years, the way that the SAT

¹¹⁹ Article 35, SAT Order No. 20, 2010.

¹²⁰ This statement was uttered by Mr. Sun Gang, an official in the research institute of the MoF. See Lin Yan, Rediscover the Rights Hidden in Taxation (in Chinese), *China Youth Daily*, 21 September 2011, available at http://zqb.cyol.com/html/2011-09/21/nw.D110000zgqnb_20110921_1-09.htm (visited 23 Dec 2013).

¹²¹ In August 2013, China entered into the Multilateral Convention on Tax Administrative Assistance which provides for different forms of administrative co-operation between states in the assessment and collection of taxes, in particular with a view to combating tax avoidance and evasion. The list of tax treaties China has entered into is available at <http://www.chinatax.gov.cn/n8136506/n8136593/n8137537/n8687294/8688432.html> (visited 23 Aug 2013).

interpreted tax treaties has experienced noticeable changes: from adopting a scattered and fragmented approach by randomly interpreting a provision in one certain tax treaty, to using the systematic and comprehensive approach to give an overall technical explanation to provisions alike in every treaty;¹²² from translating the commentaries of the OECD Model and the UN Model and transplanting rules therein, to bringing up innovative solutions to clarify certain concepts that are ambiguous under the OECD Model and the UN Model.¹²³ The growing expertise of the SAT on the interpretation of tax treaties, to some extent, can be attributable to its active participation in international organizations and more frequent dialogues with its treaty partners.

- (1) As a non-member state of the OECD, China has engaged in various discussions with respect to the revision of the OECD commentary as an observer state.¹²⁴ Consequentially, a large body of interpretative rules issued by the SAT resembles the content in the OECD commentary.
- (2) In the UN Tax Committee, China took a key position in shaping and refining tax policy in favour of developing countries.¹²⁵ It has become more vocal in articulating opinions on international tax matters.
- (3) As a member state of the G-20, China has been playing an active role in the Global Forum on Transparency and Exchange of Information for Tax Purposes and keeps improving domestic laws to live up to the international standard.¹²⁶

¹²² One of the examples is the promulgation of Circular [2010] No. 75. In this circular, the detailed interpretation is given to every single provision in the China–Singapore tax treaties at great length and the guidance therein can be used to interpret other treaties China has concluded when the same provisions are included. See SAT, Interpretation Notes on the Double Tax Agreement Concluded between China and Singapore, *Guoshuifa* [2010] No. 75, promulgated on 26 July 2010.

¹²³ One example is the interpretation on the “profits from the operation of international traffic” under tax treaties. According to the OECD commentary, such profits shall include those obtained from the wet lease of ships, i.e. leasing a ship on charter fully equipped, crewed and supplied. However, based on the SAT Circular [2010] No. 75, profits from the wet lease of ships shall not be included in the “profits from the operation of international traffic” unless the companies which derives profits from the operation of international traffic carry out the main business on international transportation, and the affiliated business, such as the wet lease of ships, does not exceed 10 per cent of the gross income within an accounting year.

¹²⁴ Li Jinyan, “The Great Fiscal Wall of China: Tax Treaties and Their Role in Defining and Defending China’s Tax Base”, (2012) 66(9) *Bulletin for International Taxation* 452–453.

¹²⁵ In July 2013, Mr. Liao Tizhong, the deputy director general of international taxation in the SAT was selected as a member of the UN Committee of Experts on International Cooperation in Tax Matters for a new term starting from July 2013 to June 2017. See http://www.un.org/ga/search/view_doc.asp?symbol=E/2013/9/Add.10&Lang=E (visited 3 Jan 2014).

¹²⁶ General Office of the SAT, China Successfully Passed the Peer Review of Global Forum on Transparency and Exchange of Information for Tax Purposes (21 June 2012), available at <http://www.chinatax.gov.cn/n6669073/n6669118/12021099.html> (visited 23 Aug 2013).

- (4) The SAT is actively engaging in the dialogue with the partners to tax treaties or arrangements to continually polish its treaty interpretation. One of the salient examples is the interpretation of treaty notion of “beneficial ownership”.¹²⁷

VII. Conclusion

The unique feature in the interpretation of tax laws in China is that administrative organs have enjoyed a near monopoly status in interpreting rules. Problems arise due to the high centralization of powers and the lack of effective checks. These problems include *ultra vires* interpretations, inconsistencies among the rules, retroactive application, infringement to taxpayers’ rights without available channels for remedies, etc.

In contrast to the strong stance of administrative bodies, the judiciary has been and may continue to remain weak in the tax field in the years to come especially when the cultural legacy, legal barriers and institutional hindrance are taken into account. The legislature has *de facto* laid aside its legislative power to interpret tax laws for three decades. The proper exercise of this power in the area of tax law depends on the self-restoration of the legislation power by the legislature.

This status quo in tax laws interpretation in China may continue in the short-medium term. However, it does not mean that the existing problems are incurable or cannot be alleviated to some extent. The momentum for changes stem from a range of factors. Thus, administrative bodies, motivated by internal regulatory constraints and external supervision, are moving forward themselves so as to adhere more closely to basic rule of law principles. Ordinary citizens, tax professionals and non-government organizations have begun to make their voices heard through various channels when tax rules are illegitimately or inappropriately interpreted by government agencies leading to adverse effects on taxpayers’ rights. Moreover, the integration of China into the international tax community requires the government to be more attentive to international norms and the practice in other countries. Some modest but significant steps are now being taken. There is still a long way to go, but as Lao Tzu once wisely advised, every journey begins with a single step.

¹²⁷ From 2009 to 2014, SAT issued four circulars to clarify the meaning of the treaty term “beneficial owner”, ie SAT Circular [2009] No. 601, SAT Bulletin [2012] No. 30, SAT Circular [2013] No. 165 and SAT Order [2014] No. 24. The way how the SAT interpreted this term in Circular [2009] No. 601 is innovative and aroused the widespread discussion in the international arena; see eg Nolan Sharkey, “China’s Tax Treaties and Beneficial Ownership: Innovative Control of Treaty Shopping or Inferior Law-making Damaging to International Law?” (2011) 65(12) *Bulletin for International Taxation* 655–661; Dongmei Qiu, “The Concept of ‘Beneficial Ownership’ in China’s Tax Treaties – the Current State of Play” (2013) 67(2) *Bulletin for International Taxation* 98–104.

