

# THE ADMINISTRATIVE USE OF LAW IN CHINA: THE *BAORI GOLF CLUB* TAX CASE

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## I. INTRODUCTION

On August 18, 1997, the Shenzhen Local Taxation Bureau (the "Local Taxation Bureau") auctioned off assets of the Baori Golf Club, a Chinese-Japanese joint venture ("Baori" or the "JV").<sup>1</sup> Out of the 260 million yuan auction proceeds, 103 million yuan went to the state treasury to satisfy the government's tax claims against the JV.<sup>2</sup> The *Baori Golf Club* tax case is significant in several respects. As *Baori Golf Club* involved over 147 million yuan tax-related claims and penalties,<sup>3</sup> the case

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1. *Shenzhen Baori Gongsì Bufen Caichan Bei Paimai* [Part of Shenzhen Baori Company's Property Was Auctioned Off], RENMIN RIBAO [PEOPLE'S DAILY], Aug. 19, 1997, at 4 [hereinafter *Property Was Auctioned Off*].

2. *Baori Shui'an Chachu Loushui You Xuwen* [An Update of the Baori Tax Case], SHENZHEN SHUIWU GONGBAO [SHENZHEN TAXATION BULL.], 1997, No. 11, at 10.

3. The sum included 70,625,790.70 yuan as overdue taxes, Guanyu Bao'an Baori Gaoerfuqiu Yule Guanguang Youxian Gongsì Shuiwu Weizhang Wenti De Chuli Jueding [Decision Concerning The Matter of Tax Violations of Bao'an Baori Golf Entertainment and Sightseeing Limited Company], Investigation Department, Shenzhen Local Taxation Bureau, *Shen Di Shui Ji Fa*, No. 092, May 29, 1996, SHENZHEN SHUIWU GONGBAO [SHENZHEN TAXATION BULL.], No. 9, at 30, 30 [hereinafter May 1996 Decision]; 52.527 million yuan as *zhinajin* or fines for late payment (calculated for the period from July 1 1996 to August 18, 1997); and administrative penalties amounting to 24,681,959.81 yuan; Shenzhen Difang Shuiwu Ju [Shenzhen Local Taxation Bureau], Guanju Baori Gaoerfuqiu Yule Guanguang Youxian Gongsì Toukangshui Anjian Chachu Qingkuang Tongbao [Announcement on the Investigation and Action Taken in the Case of Tax Evasion and Refusal to Pay Tax Involving Baori Golf Entertainment and Sightseeing Limited Company], Aug. 18, 1997, SHENZHEN SHUIWU GONGBAO [SHENZHEN TAXATION BULL.], No. 9, at 4, 7 [hereinafter Announcement on Baori]. *Zhinajin* or a fine for late payment is distinguishable from an administrative penalty. The former apply whenever taxpayers fail to pay tax within the time limit prescribed by law (comparable to an interest payment under U.S. federal income tax law). ZHONGHUA RENMIN GONGHEGUO SHUISHOU ZHENGSHOU GUANLI FA [Law of the People's Republic of China On the Administration of Tax Collection], art. 20, (adopted on September 4, 1992 and amended on February 28, 1995), 1992 FAGUI HUIBIAN 45 [hereinafter 1992 Tax Collection Law].

ranks among the top tax cases in China's history.<sup>4</sup> In an unprecedented move, the Chinese authorities openly charged the JV and its Japanese management with *toushui* or "tax evasion"<sup>5</sup> and *kangshui* or "refusal to pay tax",<sup>6</sup> each charge carrying severe administrative<sup>7</sup> and criminal penalties<sup>8</sup>

Whereas administrative fines can be imposed only if a specific tax law infraction is found, *id.*, art. 37-46, 48. For an English discussion of the 1992 Tax Collection Law, see Amy L. Sommers & Kara L. Phillips, *Assessing the Tax Administration Law of the People's Republic of China*, 18 LOY. L.A. INT'L & COMP. L.J. 339 (1996). Another difference between an administrative penalty and a fine for late payment is the method of enforcement. Tax officials can take action to enforce a fine for late payment without judicial assistance; but the enforcement of an administrative penalty calls for court action, *Zhonghua Renmin Gongheguo Xingzheng Chufa Fa* [Administrative Penalty Law of the People's Republic of China], art. 51 (adopted on March 17, 1996), GUOWUYUAN FAZHI JU [LEGISLATIVE AND LEGAL BUREAU, STATE COUNCIL], ZHONGHUA RENMIN GONGHEGUO XIN FAGUI HUIBIAN 1996 Di Yi Ji [VOL. 1, NEW COLLECTION OF LAWS AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA 1996] 9, 11 (1996) [hereinafter ADMINISTRATIVE PENALTY LAW]. For a brief description of the Administrative Penalty Law, see Dingjian Cai, *Introduction to the Administrative Penalty Law of China*, 10 COLUM. J. ASIAN L. 259 (1996).

4. See Shangguan Musheng, *Gaige De Chuangkou He Chuangkou De Gaige* [The "Window" for the Reform and the Reform of the "Window"], ZHONGGUO SHUIWU [CHINA TAXATION], 1997 No. 12, at 4, 12 (Director of the Local Taxation Bureau characterized *Baori* as "a unprecedented case of tax evasion and refusal to pay tax" in terms of its lengthy investigations, degree of difficulty in gathering evidence, and hostility of the taxpayer).

5. May 1996 Decision, *supra* note 3. *Toushui* or tax evasion is statutorily defined as the taxpayer's failure to pay, or underpayment for, the amount of tax payable "by means of forging, altering, concealing or destroying without authorization accounting books or vouchers for the accounts, or overstating expenses or omitting or understating incomes in accounting books, or filing false tax returns". 1992 Tax Collection Law, *supra* note 3, art. 40. For a background discussion of the Chinese concept of *toushui*, see text accompanying notes 227-234 *infra*.

6. The charge was added after the case went public in April 1997. Announcement on *Baori*, *supra* note 3, at 4. The offense of *kangshui* or refusal to pay tax is defined as the taxpayer's "refusal to pay tax with resort to violence or menace". 1992 Tax Collection Law, *supra* note 3, art. 45. For a background discussion of the concept of *kangshui*, see text accompanying *infra* notes 239-246.

7. The Chinese traditionally prefer informal sanctioning for minor infractions of social order through criticism, warning and censure; in case of severe violation, criminal punishments would be imposed; there were, however, instances where criticism, warning and censure might be viewed as inadequate and ineffective deterrents, but the imposition of criminal punishment would be too harsh; in those cases, an intermediate form of sanctioning and punishment called "administrative penalty" would apply. For an introduction to China's pre-reform use of administrative penalty, see JEROME ALAN COHEN, *THE CRIMINAL PROCESS IN THE PEOPLE'S REPUBLIC OF CHINA 1949-1963: AN INTRODUCTION* 200-237 (1968). Today, a broad range of administrative organs from police to tobacco bureaux are statutorily empowered to impose administrative penalty on law violations within their jurisdictions; in addition to fining, government organs can also detain and confine law violators, or seize and confiscate property. Administrative Penalty Law, *supra* note 3, art. 8. Tax law violations are subject to administrative penalty in the form of fines either in a fixed amount or as a percentage of the amount of tax overdue; if a taxpayer has failed to properly register with tax authorities and taken no remedial action after the tax authorities' notification, a fine up to 10,000 yuan will be imposed depending on the severity of the case. 1992 Tax Collection Law, *supra* note 3, art. 37. In case of *toushui* or "tax evasion", a fine up to five times the amount of tax evaded may apply. *Id.*, art. 40. The offense of *kangshui* or "refusal to pay tax" is similarly punishable by

under Chinese legislation. It was the first time the offense of *kangshui* had been publicly levelled against a foreign investment enterprise since the country's opening up in the late 1970s.<sup>9</sup> How did the Chinese authorities explain this extraordinary case? According to the Director of the Local Taxation Bureau, the local tax officials merely "administered tax according to law" (*yifa zhishui*).<sup>10</sup> The Local Taxation Bureau's decision against the JV was indeed replete with citations of legislation,<sup>11</sup> government regulations<sup>12</sup> and ministerial pronouncements.<sup>13</sup> Other official accounts of

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administrative penalty. *Id.*, art. 45.

8. In addition to administrative fines, *toushui* or "tax evasion", *kangshui* or "refusal to pay tax" and other tax offenses can be simultaneously punished by prison terms under Chinese criminal law; for *toushui* (tax evasion), a three to seven years' imprisonment applies. Supplementary Provisions of the Standing Committee of the National People's Congress Regarding the Imposition of Punishment In Respect of Offenses of Tax Evasion and Refusal to Pay Tax [Quanguo Renmin Daibiao Dahui Changwu Weiyuanhui Guanyu Chengzhi Toudhui Kangshui Fanzui De Buchong Guiding] (adopted on Sept. 4, 1992), 1, 1992 FAGUI HUIBIAN 61, 61 [hereinafter 1992 Supplementary Provisions]. Similar prison terms also apply to *kangshui* or refusal to pay tax, *id.* The 1992 Supplementary Provisions were incorporated into the revised criminal law of 1997, Criminal Law of the People's Republic of China [Zhonghua Renmin Gongheguo Xingfa] (revised on Mar. 14, 1997), arts 201-204, 211, ZHONGHUA RENMIN GONGHEGUO XINGFA [CRIMINAL LAW OF THE PEOPLE'S REPUBLIC OF CHINA] 66-67, 70-71 (Falu Chubanshe [Law Publishing House], 1997). In Baori, after the August 18, 1997 auction, the Local Taxation Bureau reportedly transferred the case to the judicial organ for criminal investigations. Announcement on Baori, *supra* note 3, at 8.

9. See text accompanying *infra* notes 243-248. *Baori* should also be the most publicised tax case against a foreign investor. It was covered by over thirty domestic newspaper and magazines and over twenty overseas news media according to an official count. Shangguan, *supra* note 4, at 13.

10. Shangguan, *supra* note 4, at 12 (interview with Wu Shengwen, Director of the Local Taxation Bureau).

11. May 1996 Decision, *supra* note 5 (referring to Consolidated Industrial and Commercial Tax Act of 1958, Income Tax Law Concerning Foreign Enterprises of 1981, Income Tax Law Concerning Foreign Investment Enterprises and Foreign Enterprises of 1991 and 1992 Tax Collection Law). Under China's law-making arrangements, the National People's Congress and its Standing Committee exercise the country's legislative power by adopting *fa* or law. XIANFA, arts. 58, 62 (1982). The term "legislation" refers to laws adopted by the National People's Congress or its Standing Committee.

12. May 1996 Decision, *supra* note 5 (mentioning Detailed Rules on the Implementation of the Income Tax Concerning Foreign Enterprises of 1982, Detailed Rules on the Implementation of the Income Tax Concerning Foreign Investment Enterprises and Foreign Enterprises of 1991). According to the Chinese Constitution, the State Council, as "the executive organ of the supreme state power organ" and "the State highest administrative organ", XIANFA, art. 85 (1982), can take administrative measures, make administrative regulations and issue decisions and orders. *Id.*, art. 89, sec. 1. As the State Council's power to issue and promulgate regulations is constitutionally established, no delegation from the legislature is required. The term "administrative regulations" refers to regulations promulgated in the name of the State Council.

13. May 1996 Decision, *supra* note 5 (two circulars from the Finance Ministry: (86) Cai Shui Zhi No. 143, and (86) Cai Shui Wai Zi No. 170). Government ministries, e.g., Finance Ministry, and departments, such as the State General Administration of Taxation, may issue orders or directives

the case<sup>14</sup> made repeated references to law.<sup>15</sup> What is the significance of

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and promulgate rules within their respective ministerial or departmental jurisdictions. XIANFA, art. 90 (1982). Ministerial pronouncements refer to directives and rules issued in the name of government ministries or departments.

14. Published accounts on the case include: May 1996 Decision, *supra* note 5; Guanyu Chafeng Kouya Bao'an Baori Gaoerfuqiu Yule Guanguang Youxian Gongsì Bufen Caichan De Gongbao [Public Announcement Concerning Sealing Up and Seizure of Certain Property of Bao'an Baori Golf Entertainment and Sightseeing Limited Company], SHENZHEN SHUIWU GONGBAO [SHENZHEN TAXATION BULLETIN], 1997 No. 8, at 4 (hereinafter Announcement on Sealing Up of Property); and Announcement on Baori, *supra* note 3. Other official accounts or comments about the case can be found in *Shenzhen Chachu Yizong Teda Shewai Toushui An* [Shenzhen has Investigated and Decided on an Extremely Important Foreign -Related Tax Evasion Case], SHENZHEN SHUIWU GONGBAO [SHENZHEN TAXATION BULL.], 1997 No. 5, at 5; *Shuifa De Zunyan Burong Qinfan* [The Dignity of Tax Law Shall Not Be Violated], SHENZHEN SHUIWU GONGBAO [SHENZHEN TAXATION BULL.], No. 32, 1997, at 4 (Interview with a leading official of the Local Taxation Bureau) [hereinafter 1997 Interview]; *Chuangzao Gongping Shuishou Huanjing* [Creating A Fair Tax Environment], SHENZHEN FAZHIBAO [SHENZHEN LEGAL DAILY], Sep. 11, 1997, at 1 (interview with Cheng Faguang, Deputy Director of the State General Administration of Taxation); and Shangguan, *supra* note 8 (interview with Director of the Local Taxation Bureau). Numerous Chinese reports and comments tracked the official position in the case. See, e.g., Ji Donghua, *Duzhu Baori Heidong* [Plugging the Black Hole of Baori], SHENZHEN FAZHIBAO [SHENZHEN LEGAL NEWS], Apr. 13, 1997, at 1; *Baori Gongsì Teda Toushui An Yinqi Qianglie Fanxiang* [The Baori Company's Extraordinary Tax Evasion Case Has Strong Resonance], SHENZHEN FAZHIBAO [SHENZHEN LEGAL DAILY], Apr. 15, 1997, at 1; He Guanghuai, *Shenzhen Baori Teda Shewai Toushui An Yuanhe Yanbiancheng Yanzhong Kangshui An* [Why Did A Major Foreign Tax Evasion Case Involving Shenzhen Baori Become A Serious Case of Refusal to Pay Tax], LIAOWANG [OUTLOOK], 1997 No. 20, at 26; Si Hai, *Xishuo Baori An* [A Detailed Account of the Baori Case], ZHONGGUO SHUIWU BAO [CHINA TAXATION NEWS], Jul. 21, 1997, at 1; Benkan Teyue Pinglun yuan [Special Commentator], *Baori Shui An Pingxi* [Comments and Analyses About the Baori Tax Case], SHEWAI SHUIWU [INTERNATIONAL TAXATION IN CHINA], 1997 No. 10, at 4 [hereinafter *Analysis About Baori*]. Cai Hongli, *Shoudu Daxuesheng Cong Baori Toushui Shijian Kan Zhifa Gangxing* [Students at the Capital Learn About The Rigour of Law Implementation from the Baori Tax Evasion Incident], ZHONGGUO SHUIWU BAO [CHINA TAXATION NEWS], Oct. 17, 1997, at 1 (interview with Professor Hao Ruyu, Head of the Department of Taxation, Central Finance and Economics University); Wang Zelei & Wang Yuxiang, *Yifa Nashui Tianjingdiyi Toushui Kangshui Fali Burong* [Paying Tax According to Law Is An Unalterable Principle Whereas Tax Evasion and Resisting Tax Are Not Tolerable Under Law], ZHONGGUO SHUIWU BAO [CHINA TAXATION NEWS], Oct. 17, 1997, at 1.

15. Most of the published documents and accounts contained general references to law as the basis for the official decision and action against Baori, e.g., May 1996 Decision, *supra* note 5; Announcement on Sealing Up of Property, *supra* note 14; and Announcement on Baori, *supra* note 3. Shenzhen municipal officials praised the action against Baori as part of the local government's efforts to govern the city according to law (*yifa zhishi*). *Jianchi Yifa Zhishi Chuangzao Lianghao Shuishou Huanjing* [Holding to the Idea of Governing the City According to Law and Creating a Good Tax Environment], SHENZHEN FAZHI BAO [SHENZHEN LEGAL DAILY], Apr. 16, 1997, at 1.

the slogan "administering tax according to law"? In China, top officials in the executive branch of the Chinese government<sup>16</sup> wield broad law-making powers. They may interpret<sup>17</sup> and implement<sup>18</sup> legislation by promulgating

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16. According to the Chinese Constitution, the National People's Congress with its Standing Committee is the organ to exercise the supreme state power, XIANFA, art. 57 (1982), whereas the State Council is the "central people's government", the executive organ of the National People's Congress as well as the state highest administrative organ. *Id.*, art. 85. This arrangement does not purport to separate government powers as the State Council is subject to the control of the National People's Congress which exercises, in theory at least, the supreme state power. On the other hand, the State Council as the state's highest administrative organ enjoys certain powers and functions of its own. Article 89 of the 1982 Constitution lists various functions and powers of the State Council, including taking administrative measures, making administrative regulations, promulgating decisions and orders, leading the works of various levels of local state administrative organs, leading and administering economic works and urban and rural constructions, leading and administering education, science, cultural, public health, sports and family planning, leading and administering civil affairs, public security and judicial administration. *Id.*, art. 89. The State Council is composed of various ministries and commissions to exercise administrative functions and powers within their prescribed jurisdictions. *Id.*, art. 90. Such constitutional arrangements suggest that while the National People's Congress and its Standing Committee may exercise their control function over the country's administrative organs through legislation and ritual acts like inspection and approval for work reports, those administrative organs have a great deal of discretion with regard to matters falling within the areas of their functions and powers.

17. Constitutionally, only the Standing Committee of the National People's Congress is empowered to interpret law, XIANFA, art. 67, sec. 4 (1982). Under a special legislative authorization, however, top administrative officials can undertake an administrative interpretation (*xingzheng jieshi*) of legislation. Resolution of the Standing Committee of the National People's Congress for Strengthening the Work of Law Interpretation [Quanguo Renmin Daibiao Dahui Changwu Weiyuanhui Guanyu Jiaqiang Falu Jieshi Gongzuo De Jueyi] (adopted on Jun. 10, 1981), 1981 FAGUI HUIBIAN 27 (the State Council and relevant ministries and departments shall interpret non-adjudication and non-procuracy laws in concrete cases). The theory is that as the Constitution confers administrative powers upon the State Council and its ministries and commissions, top administrative officials should also be able to interpret legislative provisions in connection to their administrative jurisdiction and functions. Anthony R. Dicks, *Compartmentalized Law and Judicial Restraint: An Inductive View of Some Jurisdictional Barriers to Reform*, CHINA Q., MAR. 1995, at 82, 89. Legislation adopted by the National People's Congress or its Standing Committee also often authorize the State Council to adopt implementation rules, *see, e.g.*, 1992 Tax Collection Law, *supra* note 3, art. 61; and subsequently promulgated implementation rules routinely confer an interpreting power to the relevant ministries/commissions/departments, *see, e.g.*, Zhonghua Renmin Gongheguo Shuishou Zhengshou Guanli Fa Shishi Xize [Detailed Rules for the Implementation of the Law of the People's Republic of China on the Administration of Tax Collection], art. 85, promulgated on August 4, 1993, CAIZHENGBU TIAOFA SI [LAW DEPARTMENT OF MINISTRY OF FINANCE] ZHONGGUO SHEWAI SHUISHOU FALU FAGUI XINBIAN [THE FOREIGN-RELATED TAX LAWS AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA] 120, 134 (1996) [hereinafter Implementing Rules for 1992 Tax law] (the Finance Ministry and State General Administration of Taxation are responsible for interpreting the Rules).

18. In China, law implementation (*falü shishi*) or application (*falü shiyong*) refers to the functions of state organs and officials to exercise their powers and act according to law. *See* WEN YUAN & WANG KAI, ZHENGCE FALU DUBEN [MANUAL ON POLICY AND LAW] 146 (1995) (an officially edited book for educating government officials). The law implementation or application functions are not limited to courts, procuracies or police; they extend to administrative organs and officials.

regulations and rules of their own. Such administrative regulations and rules are not reviewable in court.<sup>19</sup> In contrast, Chinese court judges are better described as "adjudication functionaries"<sup>20</sup> and their powers are limited to adjudicating the types of cases as prescribed by legislation.<sup>21</sup> As

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*Id.* at 147.

19. Chinese courts have no power to decide claims concerning the validity of legislation, administrative regulations and ministerial rules. See Zhonghua Renmin Gongheguo Xingzheng Susong Fa [Administrative Litigation Law of the People's Republic of China], art. 12(2) (adopted on Apr. 4, 1989), 1989 FAGUI HUIBIAN 1, 3 [hereinafter Administrative Litigation Law] (courts have no jurisdiction on the validity of administrative laws and regulations or administrative decisions; or orders of universal application). See also Susan Finder, *Like Throwing an Egg Against a Stone? Administrative Litigation in the People's Republic of China*, 3 J. CHINESE L. 1, 13 (1989); Pitman B. Potter, *The Administrative Litigation Law of the PRC: Judicial Review and Bureaucratic Reform*, in DOMESTIC LAW REFORMS, *supra* 21, at 270, 283. Where an administrative litigation proceeding involves the conflict between two or more regulations or rules, the judge should report the case to their superiors and the matter would ultimately be handled by the Supreme People's Court after seeking the interpretation or decision from the State Council. Administrative Litigation Law, *supra*, art. 53. In practice, the Supreme People's Court has even consulted ministerial or departmental authorities for interpreting their rules, see Zugao Renmin Fayuan Xingzheng Shenpan Ting Guanyu Tielu Xitong Zhi'an Anjian Chufa Quan Wenti De Dianhua Dafu [Telephonic Reply by the Administrative Adjudication Tribunal of the Supreme People's Court Concerning the Power to Impose Penalties in Public Security Cases Involving Railways], Mar. 20, 1990, XINGZHENG SUSONG FALU SHIYONG SHOUCHE [HANDBOOK ON LAWS FOR ADMINISTRATIVE LITIGATION] 29 (ZHONGGUO ZHENGFA DAXUE CHUBANSHE [PUBLISHING HOUSE OF THE CHINESE UNIVERSITY OF POLITICS AND LAW], 1997) [hereinafter LAWS FOR ADMINISTRATIVE LITIGATION] (the Supreme Court consulted with Department No.3 of the Ministry of Public Security concerning the apparent conflict between a Ministry of Public Security circular and a Ministry of Railroad circular). For a discussion of judicial restraint in case of such conflicts, see Dicks, *supra* note 17, at 94-95.

20. Jerome Alan Cohen, *The Chinese Communist Party and "Judicial Independence": 1949-1959*, 82 HARV. L. REV. 967, 1003 (1969). The court system as well as individual judges in China have held a rather inferior position (compared to courts and judges in the West in general and the U.S. in particular), *id.*, at 483-506.

21. The Chinese Constitution merely states that people's courts constitute the state adjudication organs, without specifying the scope of functions and powers of the courts; XIANFA, art. 123 (1982). It is separate legislation on criminal procedure, civil procedure and administrative litigation to lay down jurisdictional foundations for the courts. As Professor Cohen has observed, Chinese courts constitute part of "a single administrative system" for law enforcement purposes. Cohen, *supra* note 20, at 1003. Professor Victor Li has noted that because "the courts in China do very little, . . . it would be a mistake to focus a great deal of attention on the Chinese courts and to draw conclusions about the entire legal system on the basis of observations made about the courts". VICTOR H. LI, LAW WITHOUT LAWYERS: A COMPARATIVE VIEW OF LAW IN CHINA AND THE UNITED STATES 14 (1978). While the courts in post-Mao China have been given a greater role to play in law enforcement than before, see, e.g., Note, *Class Action Litigation in China*, 111 HARV. L. REV. 1523 (1998) (noting an increase in the use of litigation to settle disputes); to what extent court activities actually affect the country's legal development is far from obvious. Cf. Donald C. Clarke, *Power and Politics in the Chinese Court System: The Enforcement of Civil Judgments*, 10 COLUM. J. ASIAN L. 1 (1996) (discussing limitations of Chinese courts). In fact, many legal issues have been handled nonjudicially. See, e.g., John Copeland Nagle, *The Missing Chinese Environmental Law Statutory Interpretation Cases*, 5 N.Y.U. ENVTL. L. J. 517 (1996) (noting few environmental statutory

far as tax law is concerned, while the court is given a role in settling disputes between the authorities and taxpayers,<sup>22</sup> few tax cases have ended up in the courtroom.<sup>23</sup> For many Chinese citizens and businesses, taking tax officials to court can be a risky move and an unrewarding experience.<sup>24</sup> Furthermore, access to court is hampered by technical hurdles and court judges are subject to the political influence of local and central administrative officials.<sup>25</sup> Not surprisingly, the attempts of the Japanese investor in *Baori* to challenge the Local Taxation Bureau's decisions and action in court failed. Like most other tax cases in China, *Baori* remains an administrative case (*xingzheng anjian*). In contrast to a judicial case (*sifa anjian*) where the court makes a pronouncement on the dispute between the authorities and the taxpayer, the decision of tax officials in a tax administrative case authoritatively disposes of substantive issues without court involvement.<sup>26</sup> Although it is generally known that

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interpretation cases in China because environmental disputes were usually handled outside the court system). Because of the inferior position and limited functions, powers and prestige of court judges, it is not unusual that other government organs and units refuse to cooperate in executing, or even complying with, court judgments. See Clarke, *supra*, at 55-59. In any event, as court functions in China are limited, court judges can never exercise the same kind of influence over other forms of legal discourse as judicial reasoning does in a common law system.

22. 1992 Tax Collection Law, *supra* note 3, art. 56.

23. During the period from 1993 to 1995, for instance, there were less than 900 court cases brought by taxpayers against the authorities; whereas there were over 4,100 tax administrative reconsideration cases during the same period. 1996 NIAN ZHONGGUO SHUIWU NIANJIAN [1996 YEARBOOK OF CHINESE TAXATION] 384 (Zhongguo Shuiwu Chubanshe [Chinese Taxation Publishing House], 1996). For a discussion of Chinese administrative reconsideration, see *infra* note 66.

24. The President of the High People's Court of Jiangxi Province reported in 1992 that some citizens and entities expressed grave anxiety in suing administrative organs because such lawsuits could bring them more trouble particularly if their cases involved police, industrial and commercial administration or taxation. Some people believed that even if they could win a case against those officials, they would lose for the rest of their life. Attempts to bring administrative lawsuits had given rise to officials' reprisals in a few instances scaring off parties. Li Ying, Guanyu Jiangxisheng Fayuan Xingzheng Shenpan Gongzuo Qingkuang De Huibao [Report Concerning Administrative Adjudication by Courts in Jiangxi Province], Aug. 14, 1992, RENMIN FAYUAN NIANJIAN 1992 [1992 YEARBOOK OF THE PEOPLE'S COURTS] 228, 230 (Renmin Fayuan Chubanshe [People's Court Publishing House], 1995).

25. Chinese courts are subject to influence of local governments which control major personnel and funding decisions, Zhonghua Renmin Gongheguo Renmin Fayuan Zuzhi Fa [Organic Law of the People's Courts of the People's Republic of China], art. 35 & 36 (adopted on Jul. 1, 1979 and revised on Sept. 2, 1983), 1979 FAGUI HUIBIAN 29, 37-38. Local courts are responsible and report their works to local governments. *Id.*, art. 17. Moreover, courts defer to the views of relevant government ministries or departments when interpretation of law fall within the latter's jurisdiction, *supra* note 19.

26. In *Baori*, the court was involved in two limited instances with regard to the tax dispute between the authorities and the JV. First, the tax authorities needed court assistance with regard to the enforcement of administrative penalty against the taxpayer, *supra* note 3. Second, in July 1997,

administrative officials play a pivotal role in law making and interpretation in China,<sup>27</sup> little attention has been devoted to how law has actually been used in an administrative case. This Article attempts to shed light on that issue through an investigation into how the local tax officials used law while handling the *Baori* case and also develops a trilogy of law use in Chinese administrative cases.

The Chinese state views law as a tool for government administration. Law is primarily identified with administrative commands. It includes both *ex ante* rules of a legislative nature and *ex post* directives and instructions specifically addressed to issues arising from an existing case. When making a decision or taking action, a low official should find authorization in *ex ante* rules. In cases of doubt, difficulty or policy-sensitivity, he must report the case to his superiors and request *ex post* instructions. The use of law is therefore an integral part of government administration.

Next, while the hierarchical legal discourse in China gives little room for argument by the taxpayer, the officials feel bound by tradition and ideology. The tax officials therefore first try to persuade the taxpayer to comply with their decision in an effort to avoid the need for any enforcement action. In *Baori*, both *ex ante* rules and *ex post* instructions were used to induce the taxpayer's compliance. Publicly announced *ex ante* rules appealed to the taxpayer's sense of shame whereas *ex post* instructions appealed to the taxpayer's self-interest. The use or threat to use of coercion was also intended to increase pressure on the taxpayer to comply.

The third part of the use of law in *Baori* targeted at the public through mass media accounts, reports on official reaction and other commentaries. Its main purpose was to generate favorable public opinion for the tax authorities' decision and action. It also educated business people at large about their law-abiding and taxpaying duties. This campaign focused on the two catchwords: *toushui* and *kangshui*, or "refusal to pay tax". The expression *toushui* connotes capitalists' greed whereas *kangshui* invokes fear of acts of hostility and defiance taken against the Chinese state and officials. Therefore, association of the taxpayer in *Baori*

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the Japanese investor initiated an administrative litigation proceeding against the tax authorities, but for procedural and practical reasons, the Japanese plaintiff subsequently abandoned any effort of prosecution. See *infra* notes 87-94 and accompanying text.

27. For an overview of the problems associated with Chinese administrative rule making, interpretation and implementation, see PETER HOWARD CORNE, *FOREIGN INVESTMENT IN CHINA: THE ADMINISTRATIVE LEGAL SYSTEM* (1997).



with these two expressions was intended to compel ordinary people and businesses to support the tax authorities' action.

Part II presents a chronological account of how the Local Taxation Bureau handled the *Baori* case. Part III explores policy and revenue factors underlying the official decision and action in the case. Part IV analyzes the use of law between the local tax officials and their administrative superiors in Beijing. It discusses how the local tax officials justified their decision on the basis of *ex ante* rules and why and how they sought *ex post* approvals from their superiors. Part V turns to the use of law with regard to the taxpayer. It explains the two ways law was used to induce the taxpayer's compliance: by appealing to its sense of shame through reliance on publicly announced *ex ante* rules and by appealing to its self-interest through pointing to the administrative superiors' approval and showing the coercive aspect of law. Part VI looks into the use of law with regard to the public through news media. It traces the history and implications of *toushui* and *kangshui* to demonstrate how the two expressions were expected to enlist public sympathy and support.

In conclusion, the slogan "administering tax according to law" as applied in *Baori* reveals as much about how an administrative case is handled as about what law really means to Chinese officials. The trilogy of the use of law in *Baori* brought to bear basic features of legal concept and practice in China. These include the identity between law and administrative commands, the influence of moral and ideological requirements in law implementation, a hierarchical legal discourse, the dualism between law's permanence and flexibility, the dual communication channels in law, and the different forms of law for different uses. While some of these work to constrain government officials, many others impede or even prevent a meaningful non-official contribution to law making and implementation in China. The Communist Party's idea of the rule of law remains characteristically Chinese. On the one hand, the people's legitimate interests should be protected and officials' decisions and action must be under check. On the other hand, the country's political and administrative leadership has the power to decide who has a legitimate right to an interest and how official conduct should be checked.

## II. THE BAORI GOLF CLUB TAX CASE

The Baori Golf Club was set up as a Chinese-foreign co-operative joint venture enterprise in August 1987.<sup>28</sup> Its registered scope of business<sup>29</sup> was to build and operate a golf course with a restaurant, hotel and other auxiliary facilities.<sup>30</sup> According to the JV contract, the Chinese side would contribute 200,000 square meters land whereas the Japanese counterpart would invest 10 million U.S. dollars, with the net profit to be split fifty-fifty between the partners.<sup>31</sup> The Chinese partner took the chairmanship of the board of directors while the daily operation was entrusted to Japanese management.<sup>32</sup> The term of the JV was for twenty years and upon expiration the Chinese side would take over the entire business.<sup>33</sup> The joint venture partners agreed to authorize the Japanese side to recruit club members from abroad and retain all overseas membership fees for its own account.<sup>34</sup> Between February 1988 and April 1996, according to the

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28. A Chinese-foreign co-operative joint venture, also known as contractual joint venture or "CJV" is one of the forms of foreign direct investment permitted under Chinese law. When forming a CJV, the Chinese and foreign partners can set up their own schemes as to matters such as capital contribution and profit distribution. It can be much more flexible than an equity joint venture where the Chinese and foreign parties contribute capital and receive an equity interest proportionate to the size of their respective investment. Unlike an equity joint venture which must be a limited liability company, a CJV may register as a limited liability company or as an ad hoc contractual arrangement between the parties. For discussions of various forms of foreign direct investment in China, see, e.g., Jerome Alan Cohen & Stuart Valentine, *Foreign Direct Investment in the People's Republic of China: Progress, Problems and Proposals*, 1 J. CHINESE L., 161, 179-81 (1987); Michael J. Moser, *Foreign Investment in China: The Legal Framework*, in FOREIGN TRADE, INVESTMENT, AND THE LAW IN THE PEOPLE'S REPUBLIC OF CHINA 90, 100-130 (Michael J. Moser ed., 1987).

29. Under Chinese law, any business, whether domestically or foreign funded, must have an identified scope of business to be registered with and approved by the appropriate authorities; and the operation of the business will be bound thereby. For a short discussion of Chinese administrative regulations on foreign investment on this and other matters, see Shirley J. Archer, *The Role of Administrative Agencies on Regulating Joint Ventures in China*, 21 STAN. J. INT'L L., 195 (1985).

30. Announcement on Baori, *supra* note 3, at 4.

31. *Id.* In case the annual profit failed to reach two million U.S. Dollars, the foreign partner would guarantee the Chinese side one million USD profit.

32. *Id.* Under Chinese joint venture law, the board of directors "decides on the major issues concerning the venture", whereas the general manager "takes charge of the daily operation and management of the contractual joint venture". Zhonghua Renmin Gongheguo Zhongwai hezuo Jingying Qiye Fa [Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures], art. 12 (adopted on April 13, 1988), 1988 FAGUI HUIBIAN 429, 431.

33. Announcement on Baori, *supra* note 3, at 4.

34. A 1990 resolution by the board of directors stated that the Chinese partner would play no role in membership recruiting, bear no expenses and therefore claim no revenue from the collection of membership fees. Ji, *supra* note 14, at 1. In a contractual joint venture, the foreign investor is allowed to recoup its investment capital through unconventional methods such as sharing pre-tax gross profit, or gross business revenue. CHU BAOTAI & DONG WEIYUAN, ZHONGWAI HEZUO JINGYING

authorities' estimate, 3,343 members were recruited and 11.28 billion Japanese yen and 80 million Hong Kong dollars - a total equivalent of 977 million yuan - was collected in membership fees.<sup>35</sup> These proceeds were treated as the Japanese partner's funds and never showed up in Baori's accounting books; nor did the JV file tax returns with regard to such receipts.<sup>36</sup> After a field audit on February 22, 1993, the Bao'an county tax bureau<sup>37</sup> sent the JV a notice requesting information about membership fee collections for the purpose of official tax assessment.<sup>38</sup> On September 25, 1993, upon an application for instruction from the county tax bureau, the Shenzhen municipal tax bureau ruled that all club membership fees constituted the JV's taxable revenue regardless of their intended use and the treatment for financial/accounting purposes.<sup>39</sup> After taking over the case from the county tax bureau, the audit department of the Shenzhen Local Taxation Bureau sent a notice to the JV requesting relevant information.<sup>40</sup> In rejecting the request, the Japanese management of the JV challenged the application of Chinese tax law to overseas club membership recruiting activities and fee collections taking place outside China.<sup>41</sup> It further argued that the JV should have no tax liability as it had no claim to the overseas membership fees which belonged to the Japanese investor.<sup>42</sup>

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QIYE [CHINESE-FOREIGN CONTRACTUAL JOINT VENTURE ENTERPRISES] 198 (1993). Apparently, the JV contract in *Baori* adopted such methods to allow the Japanese investor to recover its investment capital by sharing gross business.

35. Announcement on Baori, *supra* note 3, at 3.

36. *Id.*, at 5.

37. The golf course was located in Bao'an county within the jurisdiction of the Shenzhen Municipal government.

38. Announcement on Baori, *supra* note 3, at 5.

39. *Id.* Chinese law does not recognize non-profit organizations for tax exemption purposes. Social clubs for pleasure, recreation and other non-profit services for members are all liable for enterprise income and turnover taxes unless a special exemption status is secured from the authorities.

40. *Id.* Since January 1994, Chinese tax bureaucracies were reorganized with the creation of two parallel systems at provincial and local levels; one is called State Taxation Bureaus in charge of collecting national tax revenue and shared tax revenue and the other called Local Taxation Bureaus for collection of local tax revenue. For a short discussion of the 1994 Tax reform, see Zhaodong Jiang, *China's Tax Preferences to Foreign Investment: Policy, Culture and Modern Concepts*, 18 Nw. J. INT'L L. & BUS. 549, 594-95 n.224 (1998). After the 1993 reform, the *Baori* case was first handled by the Bao'an Subdivision of the Shenzhen municipal Local Taxation Bureau. Subsequently the Bao'an Subdivision handed the case over to the Local Taxation Bureau because the case appeared to be too difficult for the Subdivision to handle. Announcement on Baori, *supra* note 3, at 5. In Chinese tax administration, local tax bureaux or subdivisions may transfer important or difficult cases to their superior officials for handling.

41. Announcement on Baori, *supra* note 3, at 5.

42. *Id.*

The Japanese management described the municipal tax bureau's September 25, 1993 ruling as an internal document without binding force on the taxpayer.<sup>43</sup>

On January 4, 1996, the Local Taxation Bureau filed a request for instruction with the State Administration of Taxation or the SGAT (the country's highest tax administration authorities) ("1996 Request"), specifically asking whether overseas club membership fees were subject to *yingye shui*, or "Business Tax".<sup>44</sup> The Local Taxation Bureau requested approval of the following position: although membership fees were collected outside China, they constituted payments in exchange for promised services to be provided by the club in Shenzhen and should therefore be deemed to be revenue of the JV and taxable in China.<sup>45</sup> In a reply dated February 1, 1996 ("1996 Reply"), the SGAT approved the suggested position by merely stating that membership fees received by the Japanese investor from abroad were business revenue of the JV and taxable under China's Business Tax.<sup>46</sup> The Japanese management remained unconvinced, contending that the SGAT's reply violated the Japanese investor's property rights under the JV contract.<sup>47</sup>

On May 29, 1996, the Local Taxation Bureau issued its official tax decision<sup>48</sup> to the JV (the "May 1996 Decision"), stating that Baori had

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43. *Id.*

44. *Id.* Business Tax was introduced in January 1994 under Zhonghua Renmin Gongheguo Yingye Shui Zhanxing Tiaoli [Provisional Regulations of the People's Republic of China on Business Tax] (promulgated on December 13, 1993), ZHONGGUO SHEWAI SHUISHOU FALU FAGUI XINBIAN [THE FOREIGN-RELATED TAX LAWS AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA] 56 (1996) [hereinafter 1993 Business Tax Regulations]. For discussions of China's 1993 Business Tax, see Howard Gensler, *The People's Republic of China Business Tax of 1994*, 8 TRANSNAT'L L. 103 (1995); Note, Allison E. Wielobob, *China's Choice: Tax Incentives to Fund Economic Development*, 9 TEMPLE INT'L & COMP. L. J. 413, 430-31 (1995).

45. This position has been made public, see 1997 Interview, *supra* note 14, at 6.

46. Guojia Shuiwu Zongju Guanyu Shenzhen Baori Youhao Gaoerfuqiu Guangguang Yule Youxian Gongsì Jingwai Huiyuanfei Shouru Zhengmian Yingye Shui Wenti De Pifu [Reply of the State General Administration of Taxation Concerning Collection of Business Tax on the Receipts of Overseas Membership Fees of the Shenzhen Baori Friendship Golf Sightseeing and Entertainment Limited Company], Feb. 1, 1996, GUO SHUI HAN, No. 56, 1996.

47. Announcement on Baori, *supra* note 3, at 5.

48. Under tax administration rules, the officials must make an official decision stating the fact of law violation by the taxpayer and the legal bases for the determination after a tax audit and investigation. Shuiwu Jicha Gongzuo Guicheng [Statutes of Tax Audit Works], art. 42, Dec. 1, 1995, GUOJIA SHUIWU ZONGJU ZHENGSHOU GUANLI SI [COLLECTION ADMINISTRATION DEPARTMENT, STATE GENERAL ADMINISTRATION OF TAXATION], 5 SHUISHOU ZHENGGUAN YEWU SHOUCE [5 HANDBOOK FOR TAX COLLECTION ADMINISTRATION] 221, 230 (1996) [hereinafter Statutes of Tax Audit].

received club membership fees since 1988 as a result of overseas recruiting activities conducted by the Japanese investor and that the golf courses where recruited members would play golf were located in China.<sup>49</sup> As Baori neither identified such membership fees in its books of account, nor reported them to the tax authorities, it was guilty of tax evasion.<sup>50</sup> The May 1996 Decision found the JV to have violated article 2 of the Consolidated Industrial and Commercial Tax Act of the People's Republic of China ("CICTA"),<sup>51</sup> articles 1 and 12 of the Income Tax Law of the People's Republic of China Concerning Foreign Enterprises ("Foreign Enterprise Income Tax Law" or "FEITL"),<sup>52</sup> article 1 of the Income Tax Law of the People's Republic of China Concerning Foreign Investment Enterprises and Foreign Enterprises ("Unified Tax Law" or "UTL"),<sup>53</sup> and

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49. May 1996 Decision, *supra* note 5.

50. *Id.*

51. Zhonghua Renmin Gongheguo Gongshang Tongyi Shui Tiaoli Cao'an (adopted on September 11, 1958), 1958 FAGUI HUIBIAN 126. Article 2 of the CICTA stated that "every unit or person engaged in the production of industrial products, the purchase of agriculture products, the importation of foreign goods, commercial retailing, communications, transportation, or the rendering of services shall be the taxpayer of the consolidated industrial and commercial tax and pay the consolidated industrial and commercial tax according to the provisions of the Act." For a discussion of the CICTA and its major provisions, see Timothy A. Gelatt & Richard D. Pomp, *Tax Aspects of Doing Business with the People's Republic of China*, in CHINA'S LEGAL DEVELOPMENT 101, 123-29 (John R. Oldham ed., 1986).

52. Zhonghua Renmin Gongheguo Waiguo Qiye Suodeshui Fa (adopted on December 12, 1981), 1981 FAGUI HUIBIAN 21. Article 1 of the FEITL declared in its relevant part:

Income tax shall be levied in accordance with this Law on the income derived from production, business and other sources by all foreign enterprises operating in the People's Republic of China.

FEITL, *supra* art. 1. Article 12 of the same law stated:

The tax authorities have the right to investigate the financial, accounting and tax affairs of a foreign enterprise . . . Foreign enterprises . . . must make reports according to the facts and provide pertinent information, may not refuse to cooperate and may not conceal the facts.

*Id.*, art. 12.

53. Zhonghua Renmin Gongheguo Waishang Touzi Qiye He Waiguo Qiye Suodeshui Fa (adopted on April 9, 1991), 1991 FAGUI HUIBIAN 281. Article 1 of the UTL provides in its relevant part:

Income tax shall be paid in accordance with the provisions of this law by enterprises with foreign investment within the territory of the People's Republic of China on their income derived from production, business operations and other sources.

articles 4 and 16 of the 1992 Tax Collection Law.<sup>54</sup> The Local Taxation Bureau then proceeded to assess and calculate the JV's tax and penalty liabilities on the basis of legislation, regulations and ministerial pronouncements.<sup>55</sup>

Baori was found to have collected 902,016,569.80 yuan in club membership fees between 1988 and 1993, and the Local Taxation Bureau determined that it owed 45,551,836.77 yuan in arrears of Consolidated Industrial and Commercial Tax ("CICT")<sup>56</sup> plus 22,775,918.39 in

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UTL, *id.*, art. 1.

54. Article 4 of the 1992 Tax Collection Law states: "Units and individuals that are obligated to pay tax as prescribed by law or administrative rules and regulations are taxpayers. . . . Taxpayers . . . must pay . . . and remit tax . . . in accordance with the provisions of relevant laws or administrative rules and regulations." 1992 Tax Collection Law, *supra* note 3, art. 4. Article 16 of the statute provides in relevant part:

Taxpayers must, within the time limit for tax declaration as prescribed by law or administrative rules and regulations, or as determined by the tax authorities in accordance with law or administrative rules and regulations, complete formalities for tax declaration, submit tax returns, financial and accounting statements as well as other relevant information on tax payments required of taxpayers by the tax authorities in light of the actual needs.

*Id.*, art. 16.

55. The May 1996 Decision cited the following authorities: article 16 of the CICTA, *supra* note 51 (tax authorities may punish tax evasion by imposing up to five times the amount of tax evaded); article 15 of the FEITL, *supra* note 92 (imposing fines in case of failure to report income or file tax return and fines up to five times the amount of tax evaded); and article 24 of the Zhonghua Renmin Gongheguo Waiguo Qiye Suodeshui Fa Shishi Xize [Rules for the Implementation of the Income Tax Law of the People's Republic of China Concerning Foreign Enterprises] (promulgated on February 21, 1982), 1982 FAGUI HUIBIAN 221, 228 [hereinafter 1982 Implementing Rules for FEITL] (in case of taxpayer's failure to provide information, authorities may determine the taxable revenue amount); Zhonghua Renmin Gongheguo Waishang Touzi Qiye He Waiguo Qiye Suodeshui Fa Shishi Xize [Rules for the Implementation of the Income Tax Law of the People's Republic of China Concerning Foreign Investment Enterprises and Foreign Enterprises], art. 16 (promulgated on June 30, 1991), 1991 FAGUI HUIBIAN 290 (in case a taxpayer is unable to provide information, authorities shall determine profit and taxable income with reference to industrial profit level); the 1992 Tax Collection Law, *supra* note 3, arts. 23, 40 (authorities can assess tax even where information is inadequate or non-existent; tax evasion punishable by fines up to five times the amount of tax evaded); Circular of the Finance Ministry (86) Cai Shui Zi, No. 143 (golf course subject to 5 percent of CICT) (Circular (86) No. 143); Circular of the Finance Ministry (86) Cai Shui Wai Zi, No. 170 (membership fees of golf clubs taxable under the CICT and enterprise income tax) (Circular (86) No. 170); May 1996 Decision, *supra* note 5.

56. May 1996 Decision, *supra* note 5. The Local Taxation Bureau applied the 5 percent rate to all receipts received between 1988 and 1993. The amount included a CICT surcharge of 451,008.28 yuan, which was calculated at 10 percent of the 45,100,828.49 yuan outstanding CICT. *Id.*

administrative penalties for tax evasion, i.e., 50 percent of the tax due.<sup>57</sup> As membership fees received since 1994 amounted to another 75,486,798 yuan, Baori also owed 3,774,339.45 yuan in Business Tax,<sup>58</sup> 37,743.39 yuan in City Maintenance and Construction Tax,<sup>59</sup> and 1,906,041.42 in administrative penalties for tax evasion (50 percent of the amount of the two taxes due).<sup>60</sup> The JV was also held liable under the FEITL and its successor UTL. The May 1996 Decision stated that because the taxpayer provided only partial information about membership recruiting and fee collection, the Local Taxation Bureau was unable to ascertain the actual level of the JV's taxable income and therefore had to make a determination based on the industry's average profit margin, which was 19.08 percent.<sup>61</sup> It then fixed the JV's enterprise income tax liability at 21,261,871.09 yuan for the period from 1988 to 1993.<sup>62</sup> In total, the JV was ordered to pay 70,625,790 yuan in outstanding taxes plus 24,681,959 yuan in administrative penalties.<sup>63</sup> After prescribing a thirty-day deadline for payments, the May 1996 Decision warned that the taxpayer would face serious legal consequences should it fail to comply with the law in the future.<sup>64</sup>

After paying one million yuan in overdue taxes and two million yuan as a security deposit, the Japanese management sought an administrative reconsideration of the May 1996 Decision.<sup>65</sup> According to Chinese legislation, a taxpayer who is dissatisfied with the local tax officials'

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57. *Id.*

58. *Id.* The CICTA ceased to be operative for foreign businesses on January 1, 1994. Since then, foreign investment businesses like Baori are liable to Business Tax. Jiang, *supra* note 14.

59. This tax was computed as a surcharge on any taxpayer liable for Business Tax or Value Added Tax with the rates varying between one to seven percent of the taxable basis. Zhonghua Renmin Gongheguo Chengshi Weihu Jianshe Shui Zanxing Tiaoli [Provisional Regulations of the People's Republic of China on City Maintenance and Construction Tax] (promulgated on February 8, 1985), arts. 2, 4, 1985 FAGUI HUIBIAN 145, 145-146.

60. May 1996 Decision, *supra* note 3.

61. *Id.*

62. *Id.* Using the industrial average profit margin, the Local Taxation Bureau found the taxable income of Baori to be 186,507,640.86 yuan for the period between 1988 and 1993. The amount of the enterprise income taxes due was 27,976,146.13 yuan, which, when equally spread over one hundred months from January 1988 to April 1996, was translated into a monthly tax liability of 279,761.46 yuan. As Baori was entitled under law to a one-year income tax exemption followed by a 50 percent reduction for the next two years, the above amount of income tax due was reduced by 6,714,275.04 yuan and the final figure for Baori's income tax due for the entire period was 21,261,871.09 yuan. *Id.*

63. *Id.*

64. *Id.*

65. Announcement on Baori, *supra* note 4, at 5-6.

decision may request an administrative reconsideration.<sup>66</sup> The administrative reconsideration procedure is the prerequisite to a litigation proceeding to challenge an official decision that assesses overdue taxes or imposes a fine for late payment.<sup>67</sup> While the nominal taxpayer in *Baori* was the JV, the real target of the official investigation and decision was the Japanese investor.<sup>68</sup> Thus, it was the Japanese management which sought administrative reconsideration. In a joint venture, because the Chairman of the board of directors is the legal representative of the enterprise,<sup>69</sup> his endorsement is necessary for any legal or administrative proceedings in the name of the joint venture is necessary. However, the Japanese management in *Baori* did not get the Chinese partner's endorsement<sup>70</sup> and therefore no administrative proceeding could be instituted on behalf of the JV.<sup>71</sup> A separate request by the Japanese partner for administrative reconsideration was also denied for lack of standing.<sup>72</sup> Under tax administrative reconsideration rules, only the citizen or enterprise that has been directly and adversely affected by the tax authorities' decision can

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66. Under the Chinese administrative reconsideration system, if a citizen or entity is dissatisfied with administrative officials' decision, he or she can appeal to the original decision-making organ or its immediately superior organ, which will review the original decision. For a discussion of administrative reconsideration organization and jurisdiction, see Ying Songnian & Dong Hao, *Institutional and Jurisdictional Issues in Administrative Reconsideration*, CHINESE L. & GOV'T, Fall 1991, at 69; for a discussion of the application of law in administrative reconsideration, see Ying Songnian & Dong Hao, *A Study of the Applicable Laws in Administrative Reconsideration*, CHINESE L. & GOV'T, Fall 1991, at 54. Administrative reconsideration should be viewed as part of the same administrative case, as the same local tax officials are appointed to sit in the administrative reconsideration committee to hear requests. The Administrative Reconsideration Committee of the Shenzhen Local Taxation Bureau is headed by the Director of the Bureau himself and its members include department chiefs of the Bureau. Guanyu Tiaozhen Shenzhen Difang Shuiwuju Xingzheng Fuyi Weiyuanhui Zucheng Renyuan De Tongzhi [Notification For Adjusting the Composition of the Administrative Reconsideration Committee of the Shenzhen Municipal Local Taxation Bureau], September 30, 1997, SHENZHEN SHUIWU GONGBAO [SHENZHEN TAXATION BULLETIN], 1997 No. 11, at 22.

67. 1992 Tax Collection Law, *supra* note 3, art. 56.

68. For an explanation of why the Chinese authorities targeted the Japanese investor, see *infra* notes 97-102 and accompanying text.

69. See CHU & DONG, *supra* note 34, at 92 (when a Chinese-foreign joint venture is involved in a legal proceeding, it is the responsibility of the Chairman of the board of directors to represent the enterprise as the legal representative).

70. Announcement on *Baori*, *supra* note 3, at 6.

71. The Chinese partner notified the municipal authorities that the application for administrative reconsideration was neither approved by the Chinese side nor by the CJV board of directors; it was an unilateral act of the Japanese party. *Id.* Another reason for rejection of the petition was the fact that neither the JV nor the Japanese investor paid the full amount of the government's claims as required under law. *Id.*

72. *Id.*



petition an administrative reconsideration.<sup>73</sup> Since it was the JV and not the Japanese investor, which was directly and adversely affected by the May 1996 Decision, no administrative reconsideration was granted and therefore no lawsuit could be brought against the authorities' determinations on overdue taxes and fine for late payment.

In April 1997, the Local Taxation Bureau effected a forced transfer of over 14 million yuan from the JV's bank accounts to the state treasury.<sup>74</sup> After talks between the Japanese management and local tax officials broke down, on May 23 the authorities sold Baori's ten motor vehicles which had been previously seized and applied the proceeds of 2.84 million yuan to the government tax claims after deduction for auction expenses.<sup>75</sup> When the taxpayer refused to comply with the authorities' decision, the Local Taxation Bureau declared the *Baori* case to be one of *kangshui* on April 30, 1997.<sup>76</sup> The Local Taxation Bureau made another request for instruction (the "1997 Request") with the SGAT on various points of applicable law. In its reply dated June 19, 1997 (the "1997 Reply"),<sup>77</sup> the state highest tax authorities approved the Local Taxation Bureau's determinations and action in the case. The 1997 Reply affirmed the local officials' application of a five percent CICT to overseas membership fees collected between 1988 and 1993 pursuant to the CICTA and the Circular (86) No. 143, and a five percent Business Tax to overseas membership fees collected since 1994 under the Business Tax Regulations.<sup>78</sup> On the ground that Baori had failed to report overseas membership fee collections, the SGAT agreed that article 23 of the 1992 Tax Collection Law<sup>79</sup> and article 35 of the

73. Shuiwu Xingzheng Fuyi Guize [Rules for Tax Administrative Reconsideration], art. 36(1), Nov. 6, 1993, LAWS FOR ADMINISTRATIVE LITIGATION, *supra* note 19, at 174, 180.

74. Announcement on Baori, *supra* note 3, at 6.

75. *Id.* at 6-7.

76. He, *supra* note 14, at 27; see also *Baori Gongsì Teda Tòushui An Yanbian Wei Yanzhong Kangshui An* [The Baori Company's Large Tax Evasion Case Became A Serious Case of Refusal to Pay Tax], SHENZHEN FAZHI BAO [SHENZHEN LEGAL DAILY], May 1, 1997, at 1.

77. Guojia Shuiwu Zongju Guanyu Bao'an Baori Gaoerfuqiu Yule Guanguang Youxian Gongsì Shuiwu Chuli De Pifu [Reply of the State General Administration of Taxation Concerning Handling of the Tax Matter of Bao'an Baori Golf Entertainment and Sightseeing Limited Company], Jun. 19, 1997, GUO SHUI HAN, No. 373, 1997.

78. *Id.*

79. Article 23 of the 1992 Tax Collection Law reads:

If a taxpayer is under one of the following circumstances, the tax authorities shall have the power to assess the amount of tax payable by the taxpayer:

...

(2) Accounting books are required to be established by this Law, but they

Implementing Rules for 1992 Tax Collection Law<sup>80</sup> permitted the Local Taxation Bureau to tax the entire amount of collected overseas membership fees for the CICT and its successor Business Tax. It also allowed the local officials to determine the taxable income of the JV which had failed to supply adequate information on revenue, cost and expenditure matters.<sup>81</sup> The SGAT stated that the enterprise income tax liability of Baori should be determined according to the applicable laws and regulations effective at the time membership fees were collected. Thus, fees collected before July 1 1991 were taxable according to the FEITL and related rules; but fees collected after that date were subject to the regime of the UTL and related

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are not established;

(3) Accounting books are established, but the accounts are not in order or the information on costs, receipt vouchers and expense vouchers are incomplete and difficult to check;

(4) Where an obligation to pay tax arises, the taxpayer fails to complete the formalities for tax declaration within the prescribed time limit, and after having been ordered by the tax authorities to make tax declaration within a fixed period of time, still fails to do so upon expiration of the period.

1992 Tax Collection Law, *supra* note 3, art. 23.

80. Article 35 of the Implementing Rules for 1992 Tax Collection Law states:

In the case of a taxpayer in one of the instances stated in Article 23 of the [1992 Tax Collection Law], the taxation authorities shall have the right to use one of the following methods to assess the amount of tax payable:

(1) assessing the amount of tax payable with reference to the income and profit rate of other local taxpayers engaged in the same or similar line of business on a similar scale and at a similar level of income;

...

(4) assessing the amount of tax payable according to other reasonable methods. If use of one of the aforesaid methods is insufficient to accurately assess the amount of tax payable, two or more methods may be used concurrently.

Implementing Rules for 1992 Tax Collection Law, *supra* note 17, art. 35.

81. The 1997 Reply referred to article 23 of the 1992 Tax Collection Law, *supra* note 3, article 16 of the UTL, *supra* note 53, and article 35 of Implementing Rules for the 1992 Tax Collection Law, *supra* note 17. Article 16 of the UTL provides:

Any enterprise with foreign investment . . . shall file its quarterly provisional income tax return in respect of advance payments with the local tax authorities within the period for each advance payment of tax, and it shall file an annual income tax return together with the final accounting statements within four months from the end of the tax year.

UTL, *supra* note 53, art. 16.

rules.<sup>82</sup>

On July 9, 1997, the Local Taxation Bureau seized and sealed up the JV's golf course and its facilities<sup>83</sup> and threatened a forced sale if the overdue taxes and penalties were not settled on time.<sup>84</sup> When the Japanese management failed to meet the demand on August 18, the authorities auctioned off Baori's land use rights, buildings and structures.<sup>85</sup> Most of the proceeds from the auction went to satisfy the authorities' tax claims against Baori.<sup>86</sup> Meanwhile, the Japanese investor filed an administrative suit in its own name against the Local Taxation Bureau.<sup>87</sup> While a taxpayer may not challenge the tax authorities' decision on overdue taxes and fine for late payment in court without prior administration reconsideration, Chinese law does allow a judicial proceeding to be brought without prior administrative reconsideration to review the authorities' decisions imposing administrative penalties or enforcement/protective action.<sup>88</sup> As stated before, because the Chinese partner in *Baori* distanced itself from any litigation attempts against the local tax authorities, the Japanese investor was not able to initiate a court proceeding on behalf of the JV. On the other hand, a lawsuit in its own name raised uncertainties as to what claim it might avail itself of.<sup>89</sup> A critical factor against the Japanese side

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82. 1997 Reply, *supra* note 77.

83. Announcement on Sealing Up of Property, *supra* note 14.

84. Announcement on Baori, *supra* note 3, at 7.

85. *Property Was Auctioned Off*, *supra* note 1.

86. See *supra* note 2 and accompanying text. The case was then transferred to "judicial (*sifa*) organs" to "investigate and affix legal (criminal) liabilities on those persons who were directly responsible for the offenses of tax evasion and refusal to pay tax. Announcement on Baori, *supra* note 3, at 8.

87. The Japanese investor brought an administrative litigation procedure in July 1997, claiming, among other things, that the Local Taxation Bureau applied the wrong rules and that there was no legal basis for imposing the Consolidated Industrial and Commercial Tax on Baori's pre-1994 overseas membership fees. The case was originally filed with the High People's Court of Guangdong province; it was later transferred at the High Court's discretion to the Intermediate People's Court in Shenzhen.

88. *Id.* Chinese law distinguishes an official decision which assesses overdue taxes or imposes a fine for late payment from a decision imposing administrative penalties or taking enforcement/protective action. The former is not judicable without a prior administrative reconsideration; whereas the latter is immediately justiciable. For a distinction between a fine for late payment and a fine as an administrative penalty, see *supra* note 3.

89. In response to the Japanese investor's lawsuit, the Local Taxation Bureau posited that the petitioner had no right to claim damages the JV allegedly suffered; the petitioner was able to claim damages only to the extent that it suffered on its own account. In addition, because of the three month time limit, the lawsuit could not challenge the validity of the May 1996 Decision and the enforcement action taken against the Baori in April 1997. According to the Local Taxation Bureau, the Japanese petitioner might only challenge the August 1997 public auction. The Intermediate

was the fact that top officials at the Shenzhen municipal government<sup>90</sup> and the SGAT<sup>91</sup> had all ruled against the Japanese investor. The SGAT, through special instructions, had explicitly approved the local tax officials handling of the case.<sup>92</sup> Given that Chinese court judges will generally not take an action adverse to an administrative decision which has been approved by the responsible authorities in Beijing,<sup>93</sup> the prospect of

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People's Court in Shenzhen ordered the petitioner to supply information and notarized documents to prove its standing as well as to substantiate its claim. After the Japanese petitioner failed to meet the court's order, the court refused to adjudicate on the complaint. According to latest information, the petitioner has since abandoned prosecution of the case and the court will not rule on the merits of the complaint.

90. See, e.g., *Li Youwei Zai Shi Dishuiju Diaoyan Shi Zhichu Shuiwu Gongzuo Yao Yangde Yifa Banshi* [*Li Youwei Pointed Out During His Inquiry and Research at the Local Taxation Bureau that The Work of Taxation Must Be Strictly According to Law*], SHENZHEN SHUIWU GONGBAO [SHENZHEN TAXATION BULLETIN], 1997 No. 8, at 8 (Municipal Party secretary endorsed local tax officials' efforts to fight Baori's tax evasion); *Shenzhen Shi Zhengfu Biaoshi Zhichi Shuiwu Jiguan Xingdong* [*The Shenzhen Municipal Government Expresses Its Support for the Tax Authorities' Action*], ZHONGGUO SHUIWU BAO [CHINA TAXATION NEWS], Apr. 21, 1997, at 1 (Shenzhen deputy mayor expressed full support for tax authorities' enforcement measures against Baori) [hereinafter *Municipal Government Expresses Its Support*].

91. See *Guojia Shuiwu Zongju Fujuzhang Cheng Faguang Zhichu Chachu Baori Shui'an Youhua Le Touzi Huanjing* [*Cheng Faguang, Deputy Director of the State General Administration of Taxation, Points Out that the Result of the Baori Tax Case Has Improved the Investment Conditions*], SHENZHEN SHUIWU GONGBAO [SHENZHEN TAXATION BULLETIN], 1997 No. 10, at 4 (SGAT supported local tax authorities' action against Baori from the beginning to the end and found the outcome of the case satisfactory) [hereinafter *Cheng Faguang*].

92. For discussion of replies by the SGAT to the Local Taxation Bureau in the *Baori* case, see text accompanying *supra* notes 46, 77-82.

93. Such understanding is evidenced by the case of *Gulangyu Shuizu Bowuguan v. Xiamen Shi Gulangyu Qu Difang Shuiwuju Zhengshui An* [*Gulangyu Aquarium Museum v. the Local Taxation Bureau, Gulangyu District, Xiamen City*], 20 RENMINFAYUAN ANLIXUAN [20 SELECTED CASES OF PEOPLE'S COURTS] 329 (COMPILED BY ZUGAO RENMIN FAYUAN ZHONGGUO YINGYONG FAXUE YANJIUSUO [CHINESE APPLIED LAW SCIENCE RESEARCH INSTITUTE, SUPREME PEOPLE'S COURT], 1997 (Gulangyu District People's Court, Xiamen Municipality, Dec. 23, 1996) [hereinafter *Gulangyu Aquarium* tax case]. In this case, the plaintiff, an aquarium museum, filed a petition for Business Tax exemption with the local taxation bureau, under article 6 of the 1993 Business Tax Regulations, *supra* note 84, which exempts "museums" from Business Tax. The local taxation bureau denied the petition on the ground that the Business Tax exemption granted to museums only applied to certain government approved and financed museums. The plaintiff challenged the decision in court; meanwhile, the local taxation bureau filed a request for instruction with the SGAT whose reply affirmed the local taxation bureau's position. The local taxation bureau included the SGAT's reply in its court paper. After the plaintiff read the SGAT's reply, it agreed to withdraw the complaint against the tax authorities and pay Business Tax. The court then entered a judgment to this effect. This case indicates that taxpayers view the SGAT's instruction to local tax officials as the authoritative pronouncement on the case in hand and their attempt to reverse the local officials' decision as approved by the SGAT was doomed.

winning in a Chinese court was therefore nil.<sup>94</sup> In a separate development, the Chinese partner applied for arbitration to terminate the JV contract and obtain compensation from the Japanese side.<sup>95</sup> An arbitral tribunal from the Shenzhen Branch of the Chinese International Economic and Trade Arbitration Commission subsequently decided in favor of the petitioner, terminating the joint venture contract and awarding the Chinese partner 15.1 million yuan for lost profit and 60,378,571 yuan for property loss. The termination procedure of the JV is now under way.<sup>96</sup>

### III. A POLICY AND REVENUE EXPLANATION FOR THE CASE

What happened in *Baori* can be explained on policy and revenue grounds. The Japanese investor secured by contract for itself exclusive control over club membership recruiting and fee collection from abroad.<sup>97</sup> Since membership fees constituted the main source of revenue for the golf club, this produced anger and resentment among the Chinese.<sup>98</sup> To alter the contract between the joint venture partners did not seem to be a viable option, however, as this would likely undermine Chinese credibility with foreign business communities. Tax law provided an alternative for redress. Unlike contract law which is rooted in the idea of *pacta sunt servanda*, tax

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94. There are other ways the authorities may manipulate and influence the outcome of a tax administrative litigation proceeding; for instance, the people's court would suspend the administrative litigation pending a criminal proceeding if the authorities chose to prosecute the taxpayer's tax evasion offense; the administrative litigation proceeding would proceed later on the basis of the outcome of the criminal proceeding, see ZHONGGUO XINGZHENG SHENPAN [CHINESE ADMINISTRATIVE ADJUDICATION] 540 (Huang Jie ed., 1996) (discussing court practice).

95. He, *supra* note 14, at 27.

96. In yet another development, a group of former club members filed action with the local court against the JV, seeking damages and compensation. No hearing has been scheduled as the JV is in a termination procedure. The question is how much can be left from the termination procedure to cover those civil claims. In fact, the JV still owes an administrative penalty of over 10 million yuan administrative penalty.

97. See *supra* note 34 and accompanying text.

98. According to the Chinese accounts, the Chinese partner in *Baori* was inexperienced and fraudulently induced into the contractual arrangement which had made the Japanese investor the sole beneficiary of all overseas membership fees; the arrangement was unfair in the first place. See He, *supra* note 14, at 26 (accusing the Japanese investor of pocketing membership fees which should belong to the joint venture partners together); Ji, *supra* note 14, at 2 (Japanese investor was unfair in dealing with Chinese partner). Since the Chinese partner was a local government controlled entity, any loss resulting from the JV deal was translated into a loss to the local government.

law could accommodate the country's idiosyncratic considerations.<sup>99</sup> Whereas, the Chinese felt constrained by internationally accepted contract principles and practice;<sup>100</sup> but they insisted that the joint venture contract in *Baori* did not shield the JV from liability under the country's tax law.<sup>101</sup> Resentment against the Japanese investor ran deep and led the Chinese partner to co-operate with the tax authorities.<sup>102</sup> Through its control of the board of directors of the JV, the Chinese partner refused to endorse the Japanese management's attempt to seek administrative reconsideration.

Although the JV had allegedly evaded taxes since 1988, no action was taken until 1993. The official investigation into Baori's alleged tax evasion was made possible because of a policy change in the early 1990s. During much of the 1980s, the Chinese government was heavily dependent on tax incentives and other fiscal benefits to attract foreign investment. Party propaganda stressed the importance of treating foreigners with friendship and hospitality to win their trust. To be sure, foreign businesses were still subject to legal and administrative control. During the first three decades of the People's Republic, the few remnants of foreign business received basically the same tax treatment as domestic capitalists did on the theory that all private businesses, whether domestically or foreign owned, were undesirable elements in a state-controlled socialist economy.<sup>103</sup> The country's opening up in the early 1980s caused misgivings among the Chinese about the impact of the arrivals of foreign capital on the country's economy and society.<sup>104</sup> For domestic political purposes, the leadership

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99. It is not unusual that the same matter may receive different characterizations for revenue and contract law purposes. In Australia, while an airline ticket is an enforceable agreement under contract law, it was not an agreement for stamp duty purposes. *MacRobertson Miller Airline Services v. Comm. of State Taxation (W.A.)* (1975) 50 Australian Law Journal Reports 348. In the U.S., the authorities can disregard the "form" and look into the substance of taxpayers' transactions under various doctrines like business purpose, step transaction, and "substance over form". See, e.g., Joseph Isenberg, Review, *Musings on Form and Substance in Taxation*, 49 U. CHI. L. REV. 859 (1982).

100. Cf. Deborah E. Townsend, *The Foreign Economic Contract Law of the People's Republic of China: A New Approach to Remedies*, 24 STAN. J. INT'L L. 479, 496-500 (1988) (influence of the UN Convention on contracts on China's foreign economic contract law).

101. *Analyses About Baori*, *supra* note 14, at 6.

102. See 1997 Interview, *supra* note 14, at 6 (official admission that the Chinese partner actively assisted the authorities' investigation); He, *supra* note 14, at 26 (local tax authorities gained access to Baori's computer files thanks to the Chinese partner's cooperation). The Chinese partner's assistance to the tax authorities led to the Japanese investor's claim that the whole case resulted from a conspiracy between the local tax authorities and the Chinese partner. Announcement on Baori, *supra* note 3, at 8.

103. Jiang, *supra* note 40, at 601-02.

104. *Id.*, at 620-21.

gave reassurances that legal rules and mechanisms would be firmly in place to handle the misconduct of foreigners.<sup>105</sup> It was politically unacceptable for anyone to suggest that the law should be rewritten for foreigners.

The actual law enforcement and tax administration was a different story, however. Although tax officials had incentive for tough tax administration as more tax collection would improve their performance records, they also had to respond to policy calls for promoting foreign investment in the country. As the policy tone was set to court foreign capital, rank and file tax officials were pressured to act favorably towards foreign businesses.<sup>106</sup> In keeping with the view that taxation discouraged foreign investment, tax administration should therefore be relaxed. Although this view was criticized,<sup>107</sup> it gained currency among many officials. In fact, rarely did top officials express a keen interest in tax enforcement against foreign businesses in the 1980s despite instances of

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105. For a discussion of domestic purposes of use of law and state machinery to control foreign business, see *id.*, at 622-25.

106. In China, policy and law perform different functions in directing officials' action; without going to the details, it suffices to say that while law sets a framework within which officials are supposed to act, it is often Party policy which identifies when and how officials should act. As one commentator stated, "policy shaped the application of law" in China. Note, *Concepts of Law in the Chinese Anti-Crime Campaign*, 98 HARV. L. REV. 1890, 1902 (1985).

107. Lin Rongsheng, *Sannian Lai Shewai Shuishou De Jiben Qingkuang He Jinhou Gongzuo De Yijian* [The Basic Situation of Foreign Taxation in the Last Three Years and Views on the Future Works], Dec. 19, 1983, in GUOJIA SHUIWUJU [STATE TAXATION BUREAU], SHUISHOU GONGZUO WENXIAN HUIBIAN [COLLECTED TAXATION DOCUMENTS] 788, 792 (1993) (critically discussing the view). See also Jin Xin, *Renzhen Guanhe Wuzhong Quanhui Jingsheng Jinyibu Jiaqlang Shewai Shuishou Gongzuo* [Earnestly carrying out the Spirit of the (Party Central Committee's) Fifth Session and Strengthening Work on Foreign Taxation], Nov. 23, 1989, in GUOJIA SHUIWUJU [STATE TAXATION BUREAU], SHUISHOU GONGZUO WENXIAN HUIBIAN [COLLECTED TAXATION DOCUMENTS], 1398, 1400 (1993) (one obstacle to foreign taxation was concern that taxation would dampen foreign businesses' enthusiasm in doing business in China).

reported violations of the law.<sup>108</sup> Tax action against foreign businesses, when taken at all, was low-key and lenient.<sup>109</sup>

A policy shift took place in the early 1990s when high ranking government officials started to talk openly about tough law enforcement against foreign businesses' tax violations. In June 1993, for instance, the SGAT issued a circular (the "June 1993 Circular") calling for the strengthening of foreign tax collection and enforcement.<sup>110</sup> It urged local tax officials to tighten control over transactions between related corporations for tax avoidance purposes, and to actually audit at least 30 percent of foreign investment enterprises identified as major targets within their jurisdictions.<sup>111</sup> Another task was to fight tax evasion through annual audits and screening.<sup>112</sup> The June 1993 circular declared that upon investigation and confirmation major cases of tax evasion should be publicized and dealt with severely.<sup>113</sup> Such language was quite unimaginable just a few years before.<sup>114</sup> This attitude change was partly

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108. In a 1983 speech, a deputy director of the Taxation Bureau of the Finance Ministry deplored the lax enforcement of tax law with regard to foreign businesses and personnel. Lin, *supra* note 107, at 792. The same complaints continued during much of the 1980s. See, e.g., *Caizhengbu Shuiwuzongju Fujuzhang Niu Licheng Zai Quanguo Zhixing Shuishou Xieding Gongzuo Huiyi Jieshushi De Jianghua* [Speech of Niu Licheng, Deputy Director of the State Taxation Bureau of the Finance Ministry At the Closing of the National Work Conference on Implementation of Tax Treaties], Aug. 29, 1986, in GUOJIA SHUIWUJU [STATE TAXATION BUREAU], SHUISHOU GONGZUO WENXIAN HUIBIAN [COLLECTED TAXATION DOCUMENTS], 973, 976 (1993) [hereinafter *Speech of Niu Licheng*]. In some areas about half of foreign investment enterprises were found to have committed tax evasion. *Ruhe Jianli Jingji Tequ He Shewai Shuizhi Taxi De Yanjiu Baogao* [A Study Report on How to Establish Special Economic Zones and Foreign Related Tax System], CAIZHENG YANJIU ZILIAO [FINANCE RESEARCH MATERIALS], Feb. 6, 1987, at 38, 43.

109. Despite reported law violation incidents, the official pronouncements did not order local officials to strengthen foreign tax enforcement; they did talk about taxing according to law, but some of the examples given showed that taxing according to law could in fact reduce foreign investors' tax liability. See Lin, *supra* note 107, at 790 (an early example of tax administration resulted in a reallocation of depreciation and expenses producing a tax savings for the taxpayer).

110. Guojia Shuiwu Zongju Guanyu Jinyibu Jiaqiang Shewai Shuishou Zhengshou Guanli De Tongzhi [Notification of the State Administration of Taxation Concerning Further Strengthening the Administration and Collection of Foreign Taxes], Jun. 14, 1993, GUOJIA SHUIWU ZONGJU BANGONGSHI [GENERAL OFFICE, STATE ADMINISTRATION OF TAXATION], 1993 ZHONGGUO GONGSHANG SHUISHOU FAGUI HUIBIAN [1993 COLLECTION OF INDUSTRIAL AND COMMERCIAL TAX LAWS AND REGULATIONS IN CHINA] 286 (1994).

111. *Id.*, at 287.

112. *Id.*

113. *Id.*, at 288.

114. In recent years, the Chinese government required an annual audit of foreign investment enterprises to be jointly conducted by different local departments to insure compliance with state law in the areas of capital injection, production, finance, tax, foreign exchange and imports and exports. For a summary discussion of the requirements, see Desmond Yeung & Michael To, *Annual Audit of Foreign Investment Enterprises*, CHINA TAX REV., 1997 No. 2, at 1. Similar audits conducted on domestic enterprises have existed since the early 1980s; but they did not affect foreign



attributable to a foreign investment policy shift: de-emphasizing preferential tax treatment,<sup>115</sup> re-ordering the development priority to narrow interior/coastal disparities,<sup>116</sup> and targeting hi-tech and other desirable projects.<sup>117</sup> There was growing domestic uneasiness about the massive infusions of foreign capital which were viewed as a serious menace to domestic industries.<sup>118</sup> There were also mounting allegations of abuses of Chinese law and the preference policy by foreign investors, leading to calls for greater administrative control and more rigorous law enforcement.<sup>119</sup> The policy in favor of coastal development during much of the 1980s resulted in a backlash with interior provinces and cities impatiently clamoring for more resources for local development. Coastal areas and cities like Shenzhen which have benefited most from the country's opening policy have been blamed for the country's widening economic disparities between the eastern and western regions.<sup>120</sup> To calm interior provinces and maintain domestic stability, the central government started cutting the preferences and privileges foreign businesses had taken for granted in coastal cities like Shenzhen.<sup>121</sup>

The policy change made foreign businesses like the Japanese investor in *Baori* particularly vulnerable. The golf club was a non-productive investment project with little hi-tech or special expertise<sup>122</sup> and as domestic discontent mounted over the preferences and privileges enjoyed by foreign businesses in China,<sup>123</sup> it became politically impossible to allow the Japanese investor to escape with its amassed fortune untaxed.<sup>124</sup> Parallel

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investment enterprises until recent years.

115. For a discussion of recent preference policy changes, see Jiang, *supra* note 40, at 552-54.

116. *Id.*, at 580-83.

117. *Id.*, at 585-86.

118. *Id.*, at 648-50.

119. *Id.*, at 621-23.

120. For a discussion of Chinese preferential treatment in coastal areas and recent change, see *id.*, at 567-83.

121. The most significant change in recent years has been the abolition of certain import tax exemptions for foreign investors, *id.*, at 599-600.

122. Recent official guidelines on foreign investment did not consider golf courses or clubs as a priority. In fact, according to Interim Provisions on the Guide of Foreign Investment, issued in 1995, golf courses fall within the category of "industries in which foreign investment is limited", and more specifically, wholly-foreign owned enterprises are not permitted. The state exercised a much tighter control over investments falling within this category. Zhidao Waishang Touzi Fangxiang Zhanxing Guiding, 1995 FAGUI HUIBIAN 615, 634.

123. Jiang, *supra* note 40, at 646-52.

124. Japanese businesses are known for their "tax patriotism": they prefer to pay taxes to their home government. Liu Yushan & Xu Yaping, *Yanhai Kaifang Chengshi Caizheng Diaoyan Baogao* [Report on the Financial Investigation of Coastal Open Cities], CAIZHENG YANJIU ZILIAO [FINANCIAL RESEARCH MATERIALS], Oct. 15, 1985, at 8, 13 (noting Japanese tax patriotism). In

to the foreign investment policy shift was the establishment of a new tax structure which gave local officials greater incentives to tighten tax enforcement. A tax reform in early 1994 divided all tax revenues into three categories: the central government's revenue, local revenue and shared revenue. Meanwhile it created State Taxation Bureaus and Local Taxation Bureaus for the separate collection of tax revenues.<sup>125</sup> By separating tax revenues and creating different collecting agencies, the 1994 tax reform forced local governments to depend on their own tax revenue sources and therefore encouraged local leaders to intensify tax enforcement efforts to secure local finance.<sup>126</sup> It is worth noting that the Business Tax and the enterprise income tax collected from foreign investment enterprises like *Baori* have been Shenzhen's principal source of local tax revenues.<sup>127</sup> It is little wonder then that Shenzhen municipal leaders gave their firm support for the investigation and action taken by the Local Taxation Bureau in the *Baori* case.<sup>128</sup>

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*Baori*, the Japanese investor paid taxes on club membership fees collected in Japan to the Japanese government. *Analysis about Baori*, *supra* note 14, at 7. While the Japanese investor claimed that its tax payment to the Japanese government should excuse its tax liability to the Chinese government, the tax payment to its home country was an aggravating factor in the Chinese eyes. The Chinese were willing to let foreign businesses enjoy tax benefits, but not foreign governments; when foreign investors enjoyed tax benefits, a reciprocation duty would arise, but when benefits went to foreign governments, there would be a net loss to the Chinese. *See Jiang*, *supra* note 40, at 643-44.

125. *Id.*, at 594-95 n.224.

126. The previous central-local fiscal relationship encouraged local officials to grant tax benefits or device loopholes to protect local business interests. For a short discussion of the previous fiscal arrangement. *Id.*, at 651.

127. Business Tax and income taxes have been identified as the number one and number two tax revenue sources for Shenzhen municipality. Liang Youping & Zhang Yungui, *Shenzhen Tequ Difangshui Tixi De Jiben Kuangjia* [*The Basic Framework of Shenzhen Local Taxation System*], SHEWAI SHUI SHOU [INTERNATIONAL TAXATION IN CHINA], 1995 No. 9, at 46, 47.

128. *Municipal Government Expresses Its Support*, *supra* note 90 (Shenzhen deputy mayor expressed strong support for tax investigation and action in *Baori*). *See also* Si Hai, *supra* note 14; 1997 Interview, *supra* note 14, at 7.

## IV. AUTHORIZATION AND APPROVAL: USE OF LAW AMONG OFFICIALS

A. *Identity Between Law and Administrative Commands*

The Chinese officials did not dwell on policy changes and revenue needs<sup>129</sup> to explain the *Baori* case. They stressed "administering tax according to law". For the officials, law is a tool of government administration.<sup>130</sup> The concept of law is first and foremost related to the practice of administrative commands,<sup>131</sup> disobedience of which is punishable.<sup>132</sup> In the Chinese tradition, the words of the emperor were taken to be commands and therefore law for the cabinet ministers, low officials and the entire populace.<sup>133</sup> Senior officials in a government ministry could also issue commands and therefore pronounce law to their

129. The Chinese officials did refer to the revenue needs as part of their public explanation for the case. See *infra* notes 256-258 and accompanying text.

130. See, e.g., Stanley Lubman, *Methodological Problems in Studying Chinese Communist "Civil Law"*, in CONTEMPORARY CHINESE LAW: RESEARCH PROBLEMS AND PERSPECTIVES 230, 243-55 (Jerome Alan Cohen, ed., 1970) (discussing law as administration in China).

131. In China, traditionally, "[t]he subject of law is the Emperor who looks at the universe of China from the center and perceives humans and their relations as they relate to him". William C. Jones, *An Approach to Chinese Law*, 4 REV. SOCIALIST L. 3, 4 (1978). Law is therefore "mostly concerned with the actions of officials in carrying out their public functions", *id.*, at 4. As law is "about how government functions", *id.*, at 5, it identifies with "an order of command from the emperor to his government bureaucracy". David F. Forte, *Western Law and Communist Dictatorship*, 32 EMORY L. J. 135, 158 (1983). See also Richard Baum, *Modernization and Legal Reform in Post-Mao China: The Rebirth of Socialist Legality*, 19 STUD. COMP. COMMUNISM, 69 (1986) (borrowing from Roberto Unger's terminology, characterizing Chinese legal system as "bureaucratic law"). This is not, of course, to deny the important role of non-official or customary law in traditional China. See Jonathan Ocko, *Book Review: A Review of Geoffrey MacCormack, The Spirit of Traditional Chinese Law*, 42 MCGILL L. J. 733, 735-36 (noting the recent debate on how much marriage, property, debts and contract were regulated by unofficial law or customary practice in traditional China). To the extent that official law is concerned, however, the flavor of administrative command remains strong.

132. Punishment can be "administrative", "discipline" or "law". For a discussion of those ambiguous terms, see Note, *supra* note 137. In Chinese official vocabulary, the word *fa* or "law" is broad enough to include commands, orders, and directives from one's superior; for instance, Deng Xiaoping himself called a Party internal rule requiring officials to pay for watching movies as *fa* or "law". Deng Xiaoping, Gaoji Ganbu Yao Daitou Fayang Dang De Youliang Chuantong [High Cadres Shall Give the Example of Keeping Up the Fine Tradition of Party], November 2, 1979, in DENG XIAOPING WENXUAN 1975-1982 [SELECTED WORKS OF DENG XIAOPING 1975-1982] 187, 191 (1983) [hereinafter 1975-1982 DENG XIAOPING].

133. Professor Zhang Jinfan, a leading Chinese legal historian, pointed out that an important component of lawmaking in traditional China was compilation of imperial orders/edicts; the words of the emperor supplemented the existing body of codified laws; the orders of the emperor could create as well as abolish existing laws. ZHANG JINFAN, ZHONGGUO FALU DE CHUANTONG YU JINDAI ZHUANXING [TRADITION AND CONTEMPORARY TRANSITION OF CHINESE LAW] 94 (1997).

subordinate officials with regard to a subject matter falling within their ministerial jurisdiction. Today, it seems politically embarrassing to suggest that law is constituted merely by the words of leaders and superiors.<sup>134</sup> Instead, the identity between law and administrative commands is expressed in terms of an allocation of functions based on one's power position. The top leaders through the state legislative apparatus hold the supreme power to issue commands (legislating). High officials can implement such commands from above in an operational form (interpreting law) as well as issue their own commands (supplementing law); and low officials are in charge of carrying out the commands (implementing law).

Law is therefore of great importance to internal government administration. Among officials, it is constituted by commands and directives issued by the superiors to be followed by low officials. Such commands can be *ex ante* and legislative in nature such as legislation, regulations, rules and policy statements. The superiors' commands may also be *ex post* in nature, namely, instructions and directives addressed to issues after they have arisen. As the low official remains subordinate to the commands of the state and his own superiors, he must follow those commands when carrying out his functions. The state will make sure that the officials' conduct is under check. It does this by requiring the officials to justify their decisions on the basis of existing legislation, regulations, rules, policy statements or other authoritative pronouncements.<sup>135</sup> If the matter poses special difficulties, however, the local officials will need instruction from their superiors. For the superior officials, it is important that their instructions and directives are proper under the circumstances.

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134. Leaders would only talk about the authoritarian nature of the system in a critical tone when leaders thought it fit for political purposes. Deng Xiaoping, for example, in an attempt to justify his attempt to revive the idea of law, lamented that "the words of leaders have been considered as 'law'; those who do not support what leaders have said have been labelled 'violation of law'; when leaders change their statements, 'law' changes as well". Deng Xiaoping, Jiefang Sixiang Shishi Qishi Tuanjie Yizhi Xiangqian Kan [Liberating the Mind, Seeking the Truth from the Facts and Unite and Look Ahead], Dec. 13, 1978, in 1975-1982 DENG XIAOPING, *supra* note 132, at 130, 136. Such frank remarks were uttered only for defined political purposes.

135. As a matter of official policy and regulations, tax officials in China are required to base their determinations in administrative cases on formal legislation, government regulations or ministerial rules. Under the Party leadership's slogan *Yifa Zhiguo* or "governing the country according to law", Chinese officials must make decisions or take action according to the rules of law. See Editorial, *Dali Tuijin Yifa Zhiguo Jincheng* [Greatly Accelerating the Process of Governing the Country According to Law], RENMIN RIBAO [PEOPLE'S DAILY] (Overseas ed.), Oct. 17, 1997, at 1 (quoting President Jiang Zemin's speech at the 15th National Congress of the Communist Party; stating that all government organs must perform their functions "according to law"). The regulations requiring tax officials to base their decision on law can be found in Statutes of Tax Audit, *supra* note 48, art. 42.

Therefore, input and initiatives from local officials are not only welcome but necessary. For the subordinate officials, the use of law thus means they should justify their decisions and actions on the basis of *ex ante* authorization and/or *ex post* approval from their superiors. Claiming that they were "administering tax according to law", the local officials showed their superiors that they not only honored the spirit of the relevant commands but also followed proper procedure in locating authorization as well as in seeking approvals.

*B. Precise and Unequivocal Authorization*

When locating authorization for his decision, the low official ideally seeks to rely on rules or directives which are precise and unequivocal on the matter. The Local Taxation Bureau held Baori liable to pay the CICT<sup>136</sup> based on Article 2 of the CICTA which broadly states that all individuals and units engaged in the production of industrial products, the purchase of agricultural products, the importation of foreign goods, commercial retailing, communications and transport and the rendering of services are liable for the CICT.<sup>137</sup> Article 2 was the only provision which was arguably broad enough in scope to cover a golf club. On the other hand, there was evidence that the CICTA, as enacted in 1958, did not contemplate businesses such as golf clubs. The Schedule of Taxable Items and Tax Rates attached to the CICTA ("STITR") identified three dozen service sectors and grouped them under three rates: a three percent rate applied to items like packaging, installation, design, maritime salvage, drainage, building construction, processing, repairing, testing, sewing, laundry, printing, typing, copying, photography; a five percent rate for items like food catering, hotel, leasing advertising; and a seven percent rate for various agency services.<sup>138</sup> The STITR did not mention any entertainment, sport or club facilities, let alone provide an applicable rate.

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136. See *supra* notes 51, 56-57 and accompanying text.

137. CICTA, *supra* note 51, art. 2.

138. *Id.*, Schedule of Taxable Items and Tax Rates.

The legislative history of the CICTA shed lights on why entertainment and club facilities were not specified in the STITR. The CICT was created to replace several early taxes,<sup>139</sup> one of which was the 1950 gross receipt tax.<sup>140</sup> According to the 1950 Provisional Regulations on Taxes on Industries and Commerce,<sup>141</sup> the business receipts of entertainment and sport facilities such as skating rinks, swimming pools, stadium, boating, billiard rooms, and horse racing were taxable at a two-to-five percent rate.<sup>142</sup> In 1956, however, a new tax called *wenhua yule shui* or the "Culture and Entertainment Tax"<sup>143</sup> was introduced and applied to culture and entertainment businesses like movie theatres, circuses and clubs for profit.<sup>144</sup> The Culture and Entertainment Tax supplanted the 1950 gross receipt tax as far as receipts from the provision of entertainment services were concerned.<sup>145</sup> The CICTA enacted two years later thus omitted any references to services rendered by entertainment businesses and clubs because such services were already covered by the Culture and Entertainment Tax.<sup>146</sup> The latter remained effective until 1966.<sup>147</sup> This legislative history therefore proves that the CICTA as originally enacted did not contemplate club facilities. The Local Taxation Bureau could not therefore justifiably rely on the CICTA for imposing the CICT on Baori.

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139. See, e.g., Richard D. Pomp & Stanley S. Surrey, *The Tax Structure of the People's Republic of China*, 20 VA. J. INT'L L. 1, 12-14 (1979).

140. *Id.*, at 14 n.57. For a detailed discussion of the 1950 business or gross receipt tax, see GEORGE N. ECKLUND, *FINANCING THE CHINESE GOVERNMENT BUDGET: MAINLAND CHINA 1950-1959* 58-62 (1966).

141. *Gongshangye Shui Zanxing Tiaoli* (1950 Regulations on Taxes on Commerce) (adopted on January 27, 1950 and amended on December 15, 1950), 1949-1950 FALING HUIBIAN 298.

142. *Id.* Appendix 1, Business Classification and Tax Rates for Business Tax.

143. Provisions on Culture and Entertainment Tax (*Wenhua Yule Shui Tiaoli*), art. 1 (adopted on May 3, 1956), JAN.-JUN. 1956 FAGUI HUIBIAN 191, 191.

144. Detailed Implementation Rules of the Provisions on Culture and Entertainment Tax (*Wenhua Yule Shui Tiaoli Shixing Xize*) (Implementing Rules of Entertainment Tax), art. 2, (promulgated on May 4, 1956), JAN.-JUN. 1956 FAGUI HUIBIAN 194, 194.

145. Implementing Rules of Entertainment Tax, *id.*, art. 6.

146. See 2 LIU ZHICHENG et al., *ZHONGHUA RENMIN GONGHEGUO GONGSHANG SHUI SHOU SHI CHANGBIAN* [COMPILATION OF THE HISTORY OF INDUSTRIAL AND COMMERCIAL TAXATION IN THE PEOPLE'S REPUBLIC OF CHINA] 635 (1988) (the new Culture and Entertainment Tax absorbed business or gross receipt tax paid by cultural and entertainment sectors).

147. *Id.*, at 639-40.

Where then did the Shenzhen tax officials find proper authorization for their CICT decision? They did so in ministerial pronouncements made during the 1980s.<sup>148</sup> A reply by the General Tax Bureau of the Finance Ministry to Guangdong Provincial Tax Bureau on June 8, 1985 expressly subjected foreign investment enterprises engaged in entertainment businesses, such as horse racing and golf, to the CICT.<sup>149</sup> A 1986 Ministry of Finance Circular fixed the CICT rate for golf courses at 5 percent.<sup>150</sup> Another 1986 Ministry of Finance circular explicitly included golf club membership fees as taxable revenue and income for CICT and enterprise income tax purposes.<sup>151</sup> These ministerial pronouncements unequivocally authorized the local officials to hold golf clubs like Baori liable for the CICT.<sup>152</sup>

### C. *Ex-Post Approvals*

As *Baori* involved a large claim as well as difficult legal and policy questions,<sup>153</sup> the local officials had to seek approval from their superiors on

148. The CICT as applied to domestic enterprises was displaced by a new Industry and Commerce Tax in 1973; but in 1983, the Chinese government formally decided that the CICT continued to apply to foreign investment enterprises and businesses. See Jiang, *supra* note 40, at 590-91. Meanwhile, a decision of the State Council in January 1981 gave the Finance Ministry the power to issue rulings on changes of taxable items and tax rates. Decision of the State Council Concerning Balancing Fiscal Revenue and Expenditure and tightening Financial Management (Guowuyuan Guanyu Pingheng Caizheng Shouzhi Yangge Caizheng Guanli De Jueding), Jan. 26, 1981, 1981 FAGUI HUIBIAN 95, 96. State financial and tax officials subsequently expanded the scope of the CICT through ministerial pronouncements.

149. Reply of the General Tax Bureau Concerning Imposing the Consolidated Industrial and Commercial Tax on Entertainment Service Projects of Chinese-Foreign Equity Joint Ventures, Co-operative Joint Ventures or Wholly Foreign Owned Businesses (Shuiwu Zongju Guanyu Dui Zhongwai Hezi Hezuo Jingying Huo Keshang Duli Jingying Yule Fuwuxing Xiangmu Shouru Zhengshou Gongshang Tongyi Shui Wenti De Pifu), Jun. 8, 1985, GUOJIA SHUIWUJU [STATE TAXATION BUREAU], ZHONGGUO SHEWAI SHUI SHOU FAGUI JI [COLLECTION OF CHINA'S FOREIGN TAX LAWS AND REGULATIONS] 307 (1989).

150. Circular (86) No. 143, *supra* note 55.

151. Circular (86) No. 170, *supra* note 55.

152. The Chinese officials never admitted the possibility of conflict or incongruence between the text or legislative history of the CICTA which did not contemplate golf courses/clubs on the one hand and the ministerial pronouncements which subjected golf courses and clubs to the CICT on the other hand. To present a coherence between the text of the CICTA and the ministerial pronouncements is important to the local officials' efforts to induce the taxpayer to comply with their decision.

153. Officials need not try to get approvals and endorsements from the state tax authorities in every tax administrative case. They may not have to do so if they feel comfortable with the way they apply law and make their determinations. As *Baori* involved a large amount of tax delinquencies, a tough foreign investor, and some of most difficult legal and policy issues, however, the local officials understandably took the pains to seek approval of even relatively trivial details,

an *ad hoc* basis.<sup>154</sup> They first did so in early 1996.<sup>155</sup>

Under the 1993 Business Tax Regulations, "labor services ... within the territory of the People's Republic of China" are subject to the Business Tax.<sup>156</sup> This language authorizes the officials to tax club fees that are derived from labor services inside Chinese territory. In *Baori*, the Japanese investor conducted overseas membership recruitment and fee collections outside China.<sup>157</sup> To tax overseas membership fees, the local officials rationalized that overseas members had paid fees for playing golf in Shenzhen and that "labor services," in exchange for fee payments, therefore took place in China.<sup>158</sup> No matter how sound this rationalization was, it amounted to an interpretation of what "labor services" and "within the territory" meant. However, the local officials are supposed to implement law only and are given no mandate to interpret government regulations.<sup>159</sup> Therefore, any such interpretations had no authoritative status until properly endorsed by the officials in the SGAT in charge of interpreting the government regulations in question.

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although they had a gut feeling that they made the right decision to target the JV for tax evasion.

154. Shenzhen local taxation officials sought instructions and approval for their decision and action from the superiors at the municipal, provincial and national levels. Chinese officials are under a parallel control system based on both vertical (*tiao*) and horizontal (*kuai*) principles; the vertical control principle holds low officials responsible to their superiors within the same bureaucratic line; thus, municipal tax officials report their duties and take assignments from state and provincial tax authorities. Whereas under the horizontal control principle, municipal tax officials should simultaneously report their works to, and receive instructions from, the municipal government and Party committee. For a discussion of China's vertical and horizontal control principles, see KENNETH LIEBERTHAL, *GOVERNING CHINA* 169-70 (1995). For a discussion of how the principles work for the court system, see Clarke, *supra* note 21, at 85. In *Baori*, the Shenzhen Local Taxation Bureau submitted a total of over fifty written reports and requests for instruction, over one hundred oral briefs and over twenty special communications about the development of the case to the SGAT, the Guangdong provincial local taxation bureau, and the Shenzhen municipal Party Committee and government. Shangguan, *supra* note 4, at 12. From a legal point of view, the communication between the local taxation officials and officials at the SGAT in Beijing is most interesting as it addressed the key legal and policy issues in the case. In fact, the SGAT has both rule-making and interpretation authority in the case. In contrast, the Shenzhen municipal leaders have no tax rule-making and interpretation authority, and their approval and support were intended to satisfy moral, political and administrative necessities. The Shenzhen municipal leaders endorsed the Local Taxation Bureau's decision and action primarily for revenue and official solidarity reasons.

155. See *supra* text accompanying note 44.

156. 1993 Business Tax Regulations, *supra* note 44, art. 1.

157. *Analysis About Baori*, *supra* note 14, at 7 (quoting the Japanese side's allegation).

158. 1997 Interview, *supra* note 14, at 6. It appeared that there were overseas club members who had paid fees but never came to Shenzhen to play golf. *Analysis About Baori*, *supra* note 14, at 7 (quoting the Japanese side's allegation).

159. Only high officials in the state legislative, administrative and judicial organs can interpret law, see *supra* note 17.



Another controversy concerned the identity of the party to be charged with the tax: whether the JV or the Japanese investor should be held liable to pay taxes on overseas membership fees. The Business Tax applies to business receipts which are defined as "full price and all additional charges that are collected by the taxpayer from the other party for the provision of taxable services".<sup>160</sup> According to the joint venture partners' agreement, overseas club membership fees were directly collected by and thus remained the revenue of the Japanese investor, not of the JV.<sup>161</sup> The Japanese investor thus had an exclusive claim to the overseas membership fees.<sup>162</sup> As the JV had no legal right to the money, it would seem that the JV should have no tax liability.<sup>163</sup> Yet, the Local Taxation Bureau held that the JV was liable for the taxes due on overseas membership fees,<sup>164</sup> explaining that the fees were paid by overseas members in exchange for the right to play golf in the facilities owned and operated by the JV and that therefore the fees properly belonged to the joint venture club, not to the

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160. 1993 Business Tax Regulations, *supra* note 34, art. 5.

161. *See supra* note 34 and accompanying text.

162. *Analysis About Baori*, *supra* note 14, at 7.

163. This approach is compelled by accounting principles. In accounting, the revenue recognition principle provides that "revenue is recognized when (1) it is realized or realizable and (2) it is earned". DONALD E. KIESO & JERRY J. WEYGANDT, *INTERMEDIATE ACCOUNTING* 809 (1986). Revenues are earned "when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues, that is when the earnings process is complete or virtually complete". *Id.* Article 5 of the 1993 Business Tax Regulations recognizes this principle. An apparent exception to this legal right approach under the Business Tax Regulations is provided by article 15 of the Rules for Implementation of the Provisional Regulations of the People's Republic of China Concerning Business Tax (Zhonghua Renmin Gongheguo Yingye Shui Zhanxing Tiaoli Shishi Xize), Dec. 25, 1993, CAIZHENGBU TIAOFA SI [LAW DEPARTMENT OF MINISTRY OF FINANCE] ZHONGGUO SHEWAI SHUISHOU FALU FAGUI XINBIAN [THE FOREIGN-RELATED TAX LAWS AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA] 230, 233-234 (1996), which authorizes the tax authorities to determine the sum of business revenue in case the price of service, transfer of intangible assets or sales of real property is obviously too low without a proper reason.

164. It was important for the Chinese officials to hold the JV, instead of the Japanese investor, liable for taxes on overseas membership fees. Because the Japanese investor had no proper licence to do business on its own, there might be uncertainties as to how it could be taxed. Moreover, to hold the Japanese investor liable for Chinese taxes would indicate that the authorities accepted the Japanese investor's argument that it was alone responsible for the collection of membership fees which took place outside China, and would therefore undermine the authorities' own position. Finally, there could be serious problems of enforcement if the Japanese investor was identified as the taxpayer. The authorities might not be able to take an enforcement action against the JV which remained a separate entity, and there may have been no significant assets the Japanese investor was holding in its own name in China. On the other hand, the enforcement action against the JV still hurt the Japanese investor most as the contribution of the Chinese partner mainly consisted of land, but the Japanese investor contributed cash and other assets for building and operation of the golf course and facilities.

Japanese partner.<sup>165</sup> This position rested on the assumption that the case involved a typical transaction where members paid fees to use the golf club's facilities and therefore such payment would constitute the revenue of the club. However, under the actual existing arrangement between the joint venture partners in *Baori*, the JV simply had no legally valid claim to overseas membership fees. It was thus necessary for the Local Taxation Bureau to disregard the arrangement for tax purposes,<sup>166</sup> but approval from the SGAT was required because the move looked quite unusual in light of general accounting and tax rules. The SGAT's 1996 Reply approved the local officials' positions on these issues.<sup>167</sup>

The 1997 request sought a confirmation of the Local Taxation Bureau's May 1996 Decision. When the Local Taxation Bureau issued the official tax decision in May 1996, the CICT had been replaced by the 1993 Business Tax, and the 1958 CICTR and other CICT-related rules were no longer operative. The local officials did not wish to let *Baori* escape its CICT liability for pre-1994 membership fees simply because the underlying legislation had already been repealed and the 1993 Business tax did not reach pre-1994 revenue. In addition, the 1997 request sought confirmation for the way the taxes on the club membership fees were calculated. For tax purposes, club membership fees were divided into two parts: the non-refundable part which was paid to the club and could not be claimed back by the members, and the refundable part which would be returned to members upon their resignation from the club.<sup>168</sup> In *Baori*, to complicate matters, there had been a rule change in 1994. The rule prior to 1994 was as follows: if non-refundable fees were treated by the enterprise's books of account as revenue spread over a period of several years, only the portion allocated as the revenue of a particular year was subject to the CICT and enterprise income tax for that year; on the other

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165. 1997 Interview, *supra* note 14, at 6; *Analysis About Baori*, *supra* note 14, at 7-8.

166. For a discussion of Chinese resentment against the Japanese investor, *see* text accompanying *supra* notes 97-102.

167. 1996 Reply, *supra* note 46.

168. *See* GUANGDONG DIFANGSHUI [GUANGDONG LOCAL TAXATION] 35 (Zhongshan Daxue Chubanshe [Zhongshan University Publishing House], 1995).

hand, refundable fees were not taxable if they would be clearly returned to resigning members.<sup>169</sup> After 1994, however, all club membership fees become immediately taxable as of the day of collection, but refunds to resigning members are permitted to offset the taxable revenue for the year such refund are made.<sup>170</sup> Most of the overseas membership fees in *Baori* were collected before the 1994 rule change. Should the pre-1994 rule or the new rule apply in *Baori*?

The Local Taxation Bureau applied the new rule. First, the pre-1994 rule apparently gave the taxpayer too much room for accounting manipulation with regard to both refundable and non-refundable fees. Second, to the extent that the application of the pre-1994 rule depended on the accounting methods as adopted by the taxpayer, it made little sense in *Baori*. The JV, as the nominal taxpayer, had no legal right to overseas membership fees and therefore its books of account never adopted any accounting methods with regard to the fee receipts. There was simply no accounting basis for the Local Taxation Bureau to apply the pre-1994 rule. In applying the new rule with regard to the pre-1994 fees, the local officials posited that the Japanese side had failed to provide detailed information about overseas club membership recruitment and fee collection, and as a result the authorities had the power to determine the JV's tax liabilities by using any "reasonable methods" under the 1992 Tax Collection Law.<sup>171</sup> The local officials in *Baori* believed it was reasonable to apply the new rule to all membership fees whether collected before or after 1994 and to disallow the claim for refundable fees, but sought confirmation from the state highest tax authorities for reassurance.<sup>172</sup> Again, the SGAT's 1997

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169. See Circular (86) No. 170, *supra* note 55; see also ZHONGGUO XINSHUIZHI YEWU QUANSHU [HANDBOOK FOR CHINA'S NEW TAXATION SYSTEM] 273 (WANG ZHUANLUN & WANG PINGWU, ED. 1994) (asserting the same rule applied to the 1993 Business Tax).

170. Reply of the State General Administration of Taxation Concerning Taxation of Golf Clubs (Guojia Shuiwu Zongju Guanyu Gaoerfuqiu Julebu Shuishou Wenti De Pifu), Sep. 13, 1994, GUOJIA SHUIWU ZONGJU BANGONGTING [GENERAL OFFICE, STATE GENERAL ADMINISTRATION OF TAXATION], 1994 NIAN ZHONGGUO GONGSHANG SHUI SHOU FAGUI HUIBIAN [1994 COLLECTED CHINESE LAW AND REGULATIONS ON INDUSTRIAL AND COMMERCIAL TAXATION] 264 (1995). The new rule was reaffirmed a year later in Notification of the State Administration of Taxation Concerning Certain Issues of Business Tax (Guojia Shuiwuju Guanyu Yingyeshui Ruogan Wenti De Tongzhi), Apr. 16, 1995, SHENZHEN SHUIWU GONGBAO [SHENZHEN TAXATION BULLETIN], 1995 No. 6, at 9.

171. 1992 Tax Collection Law, *supra* note 3, art. 35.

172. The 1997 Request also sought support for the application of the 1992 Tax Collection Law to transactions before 1992 as well as the application of the FEITL to overseas membership fees. Again, a question of territoriality arose with regard to the FEITL, which only taxed income derived from China. See Wang Bingqian, *Guanyu Zhonghua Renmin Gongheguo Waishang Touzi Qiye He Waiguo Qiye Suodeshui Fa Cao'an De Shuiming* [Explanations on the Income Tax Law of the People's Republic of China Concerning Foreign Investment Enterprises and Foreign Enterprise],

Reply approved the Local Taxation Bureau's views.<sup>173</sup>

The job performance of a tax official is assessed largely on the basis of the way he has followed the law and carried out his superiors' directives.<sup>174</sup> Moreover, if a powerful figure were to attempt to intervene the taxpayer's behalf,<sup>175</sup> the local officials must be able to defend their decisions and action by demonstrating their authorization. In *Baori*, there were rumors that the Japanese investor was well-connected and ready to draw on its connections to influence the outcome.<sup>176</sup> If such rumors proved to be true and the foreign investor's connection did intervene, the officials in charge of the case could find themselves in an uphill battle. Seeking understanding and approval from the highest state tax authorities was thus a defensive tactic. By requesting instructions and following them, the local

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Apr. 21, 1991, ZHONGHUA RENMIN GONGHEGUO QUANGUO RENMIN DAIBIAO DAHUI CHANGWU WEIYUANHUI GONGBAO [GAZETTE OF THE STANDING COMMITTEE OF THE NATIONAL PEOPLE'S CONGRESS OF THE PEOPLE'S REPUBLIC OF CHINA], Jul. 10, 1991, at 61, 61. In *Baori*, it was far from obvious that overseas membership fees were derived from "business operations" in China, at least, prior to June 13, 1992, as the club was open to members or customers only on that date. In contrast, the 1991 Unified Tax Law taxes all incomes of a foreign investment enterprise like *Baori* whether derived within or without China. UTL, *supra* note 53, art. 3.

173. See *supra* text accompanying notes 77-82.

174. According to the procedure governing the assessment of state taxation officials' performance, one key item is how the official in question has performed his or her administrative functions according to law, or more precisely, the official will be tested as to whether he has "resolutely carried out and observed the policies of the central government and the State General Administration of Taxation, law and regulations" and whether he has "reported to and/or requested for instruction with [his superiors] and followed the orders and instructions [from his superiors]". Provisional Methods for Assessment of Civil Servants in the State Taxation System (Guojia Shuiwuju Xitong Guojia Gongwuyuan Kaohe Zhanxing Banfa), GUOJIA SHUIWU ZONGJU [STATE GENERAL ADMINISTRATION OF TAXATION], 1996 NIAN SHUISHOU GONGZUO WENJIAN FAGUI XUANBIAN [1996 SELECTED DOCUMENTS AND LEGAL RULES CONCERNING TAXATION WORKS] 812, 819-20 (1997).

175. It is a Chinese tradition to seek such personal intervention to resolve cases with government officials rather than relying on legal procedures and reasoning. As a famous Chinese scholar put it decades ago,

When a Chinese is arrested, perhaps wrongly, the natural tendency of his relatives is not to seek legal protection and fight it out in a law court, but to find someone who knows the magistrate personally and intercede for his "favour." With the high regard for personal relationships and the importance attached to "face" in China, the Man who intercedes is always successful if his "face" is "big" enough. It is always easy, and infinitely less costly than a protracted lawsuit.

LIN YUTANG, MY COUNTRY AND MY PEOPLE 187 (HEINEMANN ASIA 1977).

176. Shangguan, *supra* note 4, at 13.

officials could no longer be said to have acted on their own.<sup>177</sup> They could take cover behind the SGAT's approvals in the event that the Japanese investor's connection did intervene.<sup>178</sup> The superiors' approvals also seemed to be important in getting help and assistance from other local government bureaucracies.<sup>179</sup> Once approved by the SGAT, the local officials' decision and actions could easily withstand a court challenge should an administrative litigation ever be successfully brought. As long as the local officials had the support of their superiors, they would not fear losing the case to the taxpayer.

#### D. *The Request for Instruction Practice*

The Local Taxation Bureau relied on internal channels to communicate with their superiors in the SGAT.<sup>180</sup> The most notable form used in *Baori* is the so-called request for instruction practice (*qingshi*).<sup>181</sup> The Local Taxation Bureau filed requests in 1996 and 1997 with the SGAT for special instruction on legal points raised in the case. It is a common practice within China's bureaucracy for officials to turn to their superiors for instruction when special problems are encountered.<sup>182</sup> Provincial and

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177. The Director of the Local Taxation Bureau claimed, rather defensively, that every decision the local officials had made and every step they had taken were approved and endorsed by their superiors. *Id.*, at 12.

178. The outcome in a case like *Baori* could well depend on how important and powerful the taxpayer's connection was; if the connection was very important and powerful, even the SGAT may feel unable to protect the local officials. That was probably a reason why the *Baori* case was brought to the attention of top state officials for instructions. A Vice-Premier of the State Council and a leading official in the Party Political and Legal Committee gave their instructions in the case and lent support to the SGAT.

179. Cf. Shangguan, *supra* note 4, at 12 (the municipal government was able to dispatch security and judicial officers to protect local taxation officials when threatened by the Japanese management of *Baori*). This was largely because, again, of the traditional identity between law and administrative command in China. While low officials can exercise their administrative commands and therefore pronounce law to the ordinary people, they lack such capacity vis-à-vis their superior or even officials in other government branches or departments. To give their decision and action more force of authority and therefore more security, low officials need to obtain support or, at least, consent from their superiors. The Local Taxation Bureau indeed relied on the instructions of the SGAT and top state officials as evidence with which to convince municipal government officials that their decision and action in *Baori* were correct and justified.

180. For an introduction to forms of communication within the Chinese bureaucracy, see Michel Oksenberg, *Methods of Communication within the Chinese Bureaucracy*, CHINA Q., Jan.-Mar. 1974, at 1.

181. The local officials also used other ways of communication with their superior, such as written reports and oral briefs.

182. Under the request for instruction practice (*qingshi huibao zhidu*), when taking on an important task or handling an extraordinary matter, a government official should approach his superiors to make sure he clearly understands the tasks entrusted, requirements to be followed,

municipal tax officials refer sensitive legal or policy issues to the highest state tax authorities for instruction.<sup>183</sup> The request for instruction practice opens a valuable channel for officials to gain access to their superiors' intentions and wishes.<sup>184</sup> Meanwhile, the superior officials can focus on concrete problems through instruction in a way not permitted by other means of communication.<sup>185</sup>

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objectives to be attained, important matters to be kept in mind, and measures to be taken. After the instructions come down, the official must carry them out and while make periodical reports to the superiors to keep them informed of the latest development; after the task is completed, he should make a timely report to that effect. GONGWUYUAN XINGWEI GUIFAN DUBEN [MANUAL FOR CIVIL SERVANTS' CONDUCT] 106 (Peng Faxiang et al. ed., 1996) (hereinafter PENG XINGWEI). According to another source, the request for instruction practice applies in the following six cases when: (1) the case involves matters that can be handled only with the approval of the superiors; (2) there are unclear points or differences during the course of implementing Party and state policies, laws, rules or regulations; (3) a new situation or issue emerges without adequate guidance under the existing authorities; (4) extraordinary issues or issues of extreme importance arise; (5) there are uncertainties as to the correctness or appropriateness of the way the case is handled; or (6) there are major issues concerning the competence of more than one bureaucracy and therefore requiring co-ordination. DANGDAI ZHONGGUO GONGWUYUAN SHIYONG WENSHUXUE [PRACTICAL OFFICIAL COMMUNICATIONS FOR CIVIL SERVANTS IN CONTEMPORARY CHINA] 249 (Wang Shihao ed., 1997). The request for instruction practice can be traced to imperial bureaucratic practices. Cf. CHANG LINRUI & ZHANG JINTAO, ZHONGGUO LIDAI WENSHU [CHINESE DYNASTIC WRITTEN COMMUNICATION FORMS] 283-64 (1996) (*Pida* or "written answer" refers to the emperor's reply to ministers' reports or requests since Tang Dynasty).

183. Statutes of Tax Audit, *supra* note 48, art 40 (in case of important or difficult tax cases, auditing officials shall report to their superior tax authorities before making determination). In addition, low officials may file a request with their superior for instruction regarding related policy matters, *id.*, art. 44(2). See also GUOJIA SHUIWU ZONGJU ZHENGCE FAGUI SI [POLICY AND LAW DEPARTMENT, STATE GENERAL ADMINISTRATION OF TAXATION], SHUIWU ZHIFA QUANSHU [HANDBOOK OF TAX LAW ENFORCEMENT] 630-31 (ZHONGGUO JINGJI CHUBANSHE [CHINA ECONOMIC PUBLISHING HOUSE] 1997) (hereinafter HANDBOOK OF TAX LAW).

184. Although the request for instruction practice has not become a codified rule, PENG XINGWEI, *supra* note 182, at 105, it is nevertheless the duty of low officials to make such request when the circumstances call for, *id.* at 106. In other words, the low officials must make a determination, based on their judgments and experiences, as to whether filing requests for instruction is necessary. Such a determination can be very important as the failure to file requests for instruction may constitute negligence, dereliction or even disobedience in some cases, whereas in other cases too many requests could be viewed as the sign of incompetence or irresponsibility. Cf. WANG, *supra* note 182, at 254 (warning against abuse or inappropriate use of the request for instruction practice). To avoid mistakes, low officials may informally approach their superiors first to get a sense as to whether any formal requests for instruction would be necessary.

185. In China, certain internal communication forms are intended to deal with problems or assign tasks in a rather general fashion, see Oksenberg, *supra* note 180, at 3-15 (meetings including work conferences, special meetings, symposia, etc.); whereas, other forms of communication may have a more specific audience and particular problems in mind, *id.*, at 17 ("responses to specific requests for guidance from below (*p'i-fu ch'ing-shih*) . . . apply to one locality but which are circularized for general information"). In fact, instructions of the SGAT to particular requests from local officials are not always circulated for general information. In *Baori*, for instance, neither the 1996 nor 1997 Replies appeared to be intended for general information.

The request for instruction practice gave officials certain advantages in securing approval from their superiors. It was not open to the taxpayer and therefore excluded the taxpayer's side of story. Only the local officials' version of the fact and arguments appeared in the request.<sup>186</sup> For example, as discussed previously, a key issue in the 1996 request was whether overseas membership fees constituted revenue of the JV or the Japanese investor. Under a formalist approach,<sup>187</sup> the JV in *Baori* would not be held liable for paying taxes on overseas club membership fees which it had never received. However, the local taxation officials preferred a more substantive approach. Accordingly, because the JV had provided services to overseas club members, overseas membership fees should be treated as the JV's revenue. The persuasive force of the substantive approach no doubt lay in the officials' account of the facts and explanations as to how heinous the Japanese investor's tax avoidance/evasion scheme was.<sup>188</sup> According to such an account, the superior officials in the SGAT had no choice but to approve the local officials' approach if they wanted to see the tax avoidance scheme stopped.

The local officials appealed to their superiors' sense of official solidarity. Their message was: we made a decision we believed most suitable under the circumstances; your approval would be greatly helpful in getting our job done and with your approval we will be able to achieve the objective of punishing the tax evasion/avoidance act. The superior officials must have been mindful of how their response would impact the lower officials' morale. Disapproval on the part of their superiors would cause the local officials to lose face and appear incompetent. Although the superior officials in the SGAT have the responsibility to oversee tax

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186. In Chinese practice, the low officials' request usually consists of two parts: the question or matter involved and the suggested answer or solution to be adopted. SONG SHIQIN, WENSHU XUE JICHU [THE BASICS OF OFFICIAL COMMUNICATION] 98 (1998).

187. For a discussion of the approach, see *supra* note 163.

188. While tax evasion is generally understood as illegal, the term "tax avoidance" has been quite ambiguous; some define it as "legal means to escape tax", B. GUY PETERS, *THE POLITICS OF TAXATION* 193 (1991), others are not so confined, see, e.g., ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, *INTERNATIONAL TAX AVOIDANCE AND EVASION* 16 (1987) ("governments tend to take an operational approach towards tax avoidance to cover those forms of tax minimisation which are unacceptable to governments"). The distinction between acceptable and unacceptable tax avoidance raises, however, a question of "whether moral judgements are being made", *id.* While in practice, moral judgements seem to be inevitable, it has been suggested that "it is not appropriate for tax authorities to do so: in combating tax avoidance the tax authorities, in their official capacity, are simply administering the law in accordance with what they understand to have been the intention of the legislature". *Id.* In China, as moral judgments always enter into tax law administration and the intention of the legislature may play no meaningful role in law interpretation, the legal and moral distinction cannot be objectively observed.

administration at local levels, there was no indication that they engaged in any independent investigation into the matter in question. What they did instead was to confirm that the approach taken by the local officials was appropriate to the facts as described. The officials in the SGAT did not have to state any reason for their approval. The 1996 Reply, for instance, simply endorsed the propositions of the Local Taxation Bureau without elaboration.<sup>189</sup> The officials in the SGAT might also choose, however, to remind the local officials of the legal principles involved, as they did in the 1997 Reply.<sup>190</sup>

## V. APPEALS TO ONE'S SENSE OF SHAME AND SELF-INTEREST: USE OF LAW WITH REGARD TO THE TAXPAYER

### A. *A Hierarchical Legal Discourse and the Influence of Tradition and Ideology*

As low officials embody administrative authority and therefore law when carrying out their governmental functions, the people have the duty to follow the law and obey commands.<sup>191</sup> The Chinese official theory holds that "only a state organ with the legal power can use (*qiyong*) law", i.e.,

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189. 1996 Reply, *supra* note 46.

190. The 1997 Request, *supra* note 77. What could happen if the facts stated in the local officials' request were wrong or even fabricated? Because the lower officials were solely responsible for the accuracy of the facts, the superior officials should be free of blame if the facts upon which their approval was premised turns out to be untrue. Lack of any independent inquiry can in fact work as a shield to protect the superior officials. One might even speculate that the superior officials may not want to undertake any independent inquiry in order to avoid potential risks. Any independent inquiry by the superior officials would require the commitment of additional manpower and expertise, which can be quite costly and time-consuming. The Shenzhen local tax officials were touted by the state authorities as models for fighting tax evasion for other officials in the country. In September 1997, over thirty tax officials from various parts of the country met in Shenzhen to learn about the Shenzhen local taxation officials' experiences in handling the *Baori* case. *Guojia Shuiwu Zongju Chachu Baori Shui An Xianchang Zongjie Ji Zhuanran Dingjia Shuishou Guanli Jingyan Jiaoliu Hui Zai Shenzhen Zhaokai* [The State General Administration of Taxation Convened An Exchange of Experience Meeting Concerning the On-Spot Summary for the Handling of the Baori Tax Case and Transfer Pricing Tax Administration in Shenzhen], SHEWAI SHUIWU [INTERNATIONAL TAXATION IN CHINA], 1997 No. 10, at 9; *Guojia Shuiwu Zongju Zai Shen Zhaokai Xianchang Hui* [The State General Administration of Taxation Has Convened An On-Spot Meeting in Shenzhen], SHENZHEN FAZHI BAO [SHENZHEN LEGAL DAILY], Sept. 11, 1997, at 1.

191. A major purpose of administrative penalty is to punish those who violate administrative rules or disobey administrative control. See Administrative Penalty Law, *supra* note 7, art. 3 (citizens, legal persons or other entities shall be administratively punished if they violate the order of administrative control).



apply law to concrete cases.<sup>192</sup> Ordinary people are not supposed to contend points of law with the officials. Not only would such a contention violate the etiquette of hierarchical respect, but also it could effectively separate law from the political/administrative power, therefore undermining the very foundation of law.<sup>193</sup> For organizational purposes, enterprises are administratively subordinate to relevant government bureaucracies. The tax officials have administrative authority and command over citizens and businesses with regard to taxation matters. In *Baori*, the Japanese management's claim that the 1996 Reply exceeded the SGAT's power enraged Chinese commentators<sup>194</sup> who were also shocked by the contention that the Ministry of Finance had no power to extend the scope of the CICTA to golf courses and clubs.<sup>195</sup> The taxpayer's effort at arguing the law was not accepted as a legitimate exercise of any right<sup>196</sup> since only the tax authorities or their approved consultants can know what the tax law is.<sup>197</sup> Therefore, the taxpayer must be on the wrong side of law if her reading of legislation differs from that of the officials.<sup>198</sup>

On the other hand, although the taxpayer or member of the public may not argue points of law with the authorities, she may have a legitimate interest<sup>199</sup> in confirming that the official act in question is proper and acceptable. The local tax authorities should therefore try to avoid coercive action by persuading the taxpayer to accept and comply with their decision. In *Baori*, although the local tax officials were statutorily empowered to

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192. Wen & Wang, *supra* note 18, at 146.

193. The Chinese bureaucratic tradition does not accept the idea that a legal text can be read or interpreted under some neutral and objective tests, as law interpretation in China is an authority-based business, instead of a methodological matter. Cf. *supra* note 17. If a competent authority makes a pronouncement, that will be an authoritative interpretation of law, no matter which method or rule the interpreter has used.

194. He, *supra* note 14, at 26.

195. *Analysis About Baori*, *supra* note 14, at 6.

196. *Id.*, at 5-8 (characterizing Baori's legal arguments as "casuistry" and "attempts to confuse").

197. *Id.*, at 8-9.

198. The Chinese view was that if the taxpayer was puzzled by complicated tax law issues, it must try to resolve them through sincere cooperation with the officials; it should not insist on its own views and arguments. *Id.*, at 9.

199. For a discussion of the Confucian recognition of legitimate interests, see Edward Shils, Reflections on Civil Society and Civility in the Chinese Intellectual Tradition, in *CONFUCIAN TRADITIONS IN EAST ASIAN MODERNITY* 38, 55-56 (Tu Wei-ming ed., 1996). For a discussion of the Chinese concept of right and interest, see Randall P. Peerenboom, Rights, Interests, and the Interest in Rights in China, 31 *STAN. J. INT'L L.* 359 (1995).

enforce their decision,<sup>200</sup> they tried for months to induce the taxpayer to comply with their decision voluntarily. In the eyes of many Chinese, a dispute is bad publicity for the disputants.<sup>201</sup> Perception is more important than reality. If there is in fact a dispute but the parties have quietly worked out their problems, their image will not suffer. The Confucian ideology treasures harmony, praises compromise and frowns upon coercive force. In tax cases, officials also tend to avoid coercion because tax is said to reflect their moral disposition. In the Confucian tradition, a benevolent government should refrain from excessive taxation and adhere to tax leniency instead.<sup>202</sup> A tax dispute signals the taxpayer's discontent and might therefore raise questions about the morality of the officialdom. In handling tax disputes, officials are instructed to display understanding and compassion and avoid treatment which might appear harsh.<sup>203</sup> Traditionally, they exhibited great reluctance to take taxpayers' property to satisfy government tax claims.<sup>204</sup>

Tradition remains strong to date.<sup>205</sup> In *Baori*, the Local Taxation Bureau did not publicize the case or take any enforcement action until

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200. If the taxpayer refuses to pay taxes, the local authorities can take enforcement measures by seizing the taxpayer's bank accounts or impounding, sealing up and auctioning the taxpayer's property. 1992 Tax Collection Law, *supra* note 3, art. 27.

201. In traditional China, "[d]isputes were viewed as disruptions of natural harmony which linked individual, group, society, and the entire universe". Stanley Lubman, *Mao and Mediation: Politics and Dispute Resolution in Communist China*, 55 CAL. L. REV. 1284, 1291 (1967).

202. For a discussion of the relationship between tax and the concept of benevolent government, see Jiang, *supra* note 40, at 612-18.

203. As showed in a Qing tax revolt case, a high imperial official blamed local government officials' "illicit taxation" for the revolt, and the final imperial edict on the case adopted this position and exonerated the leader of the rebellion. Two local officials involved in the suppression of the revolt were instead held responsible and condemned to death. Guangyuan Zhou, *Illusion and Reality in the Law of Late Qing: A Sichuan Case Study*, 19 MODERN CHINA 427, 443-44 (1993).

204. A study on taxation in Ming Dynasty found, for instance, that local officials avoided enforcement action against delinquent peasants because such action was contrary to the "traditional concept of good government". RAY HUANG, *TAXATION AND GOVERNMENTAL FINANCE IN SIXTEENTH-CENTURY MING CHINA* 146 (1967).

205. Prior to 1949, the Communist Party castigated the tax system of the nationalist government as excessive, oppressive and unjust. Once it was in power, Party leadership urged its own officials to conduct themselves in a virtuous way not to give rise to excuses for taxpayers' discontents. The first national tax regulations passed after the founding of the People's Republic required tax officials to conduct a simple life style, be keen in educating taxpayers in case of tax law violations and to not abuse their power by inflicting excessive punishments such as the confiscation of taxpayer property. General Principles of National Tax Administration (Quanguo Shuizheng Shishi Yaoze) (adopted on January 27, 1950), art. 7 & 10, 1949-1950 FALING HUIBIAN 283, 285.

April 1997, almost one year after its May 1996 Decision against the taxpayer. During this period, the local officials tried to demonstrate sincerity and patience despite the alleged obduracy of the Japanese management of the JV.<sup>206</sup> The hesitation in taking coercive action stemmed also from concern over the additional time and manpower commitments involved if the case went public.<sup>207</sup> The official preference for a quiet disposition of the case was further supported by the fear that any enforcement measure<sup>208</sup> could have a negative impact on foreign investment in general.<sup>209</sup> The *Baori* case shows two ways in which Chinese officials used law to persuade the taxpayer to comply with their decision. Initially, the local tax officials relied on publicly announced rules to appeal to the taxpayer's sense of shame. Alternatively, they invoked their superiors' instruction as well as legal coercion in the hope that the taxpayer would be persuaded of the futility of continued resistance.

### *B. Appeal to the Taxpayer's Shame*

To induce the taxpayer to comply with their decision, the officials tried to convince the *Baori* management that it had violated law. The idea was that if the taxpayer knew of its law violation, it would be shamed into complying with the official decision. To appeal to the taxpayer's shame, the officials relied on publicly announced rules as the basis for the alleged law violation. A charge of violating rules which are publicly announced is much more likely to give rise to a sense of shame in the taxpayer than an accusation based on rules which are obscure to the public. The Chinese tradition and ideology stress persuasion, education and cultivation as the

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206. Shangguan, *supra* note 4, at 13.

207. As in *Baori*, when an open dispute arises, the local officials have to defend their decision by seeking approval from their superiors as well as by providing public explanations of the case.

208. In the Chinese mind, "[c]oercion, like dictatorship, is something that one applies to the enemy", Clarke, *supra* note 21, at 35. This idea has, at least, partly accounted for Chinese reluctance to use coercive measures to enforce court judgments, *id.*, at 35-37.

209. Shangguan, *supra* note 4, at 11 (Director of the Local Taxation Bureau referred to concerns about the potential negative impact of the case on foreign investment).

best means for leading the people and governing the country. Public dissemination of norms was part of the education process to help internalize correct values. A ruler may blame no one except himself if he did not teach the people proper behavior and, as a consequence, deviation occurred. The people should thus be told what was right and expected of them versus what was wrong and not to be tolerated. If the people were so informed and educated, they would be motivated to behave properly and feel ashamed if they committed wrong.

To induce compliance with their decision imposing the CICT, the officials in *Baori* eschewed ministerial pronouncements as the rules which the taxpayer had violated. Although the 1980s ministerial pronouncements specifically extended the CICT to foreign-funded golf clubs and therefore authorized the official imposition of the CICT on the JV, they were intended for internal use<sup>210</sup> and, as such, could not be relied upon as a proper basis for holding the taxpayers guilty of violating law. Instead, the Chinese insisted that, by not paying the CICT, the taxpayer violated the CICTA.<sup>211</sup> They pointed to the broad language of article 2 of the Act and held the JV liable for the CICT because it engaged in a "rendering of services".<sup>212</sup> This was not so much because article 2 was intended to create a CICT liability on golf clubs.<sup>213</sup> Rather, it was because article 2 was a publicly announced legislative provision. There was thus a paradox in the way the tax officials used law here. To appeal to the taxpayer's sense of shame, the local officials had to rely on article 2 of the CICTA which was

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210. This author has not been able to locate a published copy of the two ministerial circulars from the 1980s, i.e., Circular (86) No. 143 and Circular (86) No. 170, *supra* note 55, subjecting golf courses and clubs to the CICT.

211. See May 1996 Decision, *supra* note 5.

212. See *Analysis About Baori*, *supra* note 14, at 6 (arguing that the terms "rendering of services" in article 2 were broad enough to cover golf courses and clubs; absence of any entertainment, sport or club facilities in the STITR did not operate as limits on the scope of article 2).

213. As originally enacted, the CICTA did not contemplate clubs, sport, recreation or entertainment facilities. See *supra* notes 137-147 and accompanying text.

a publicly announced rule; but in terms of substance, article 2 was not specific enough to convince a golf club that it was subject to the CICT. Rather, it was the ministerial pronouncements during the 1980s which had expanded the CICT liability to golf courses. Yet, while the ministerial pronouncements might be substantively more persuasive, they were not publicly announced rules and therefore not in the right form to appeal to the taxpayer's sense of shame.<sup>214</sup>

It is apparent that the way law was used to appeal to the taxpayer's sense of shame was different from the way law was relied upon to show proper authorization to the superiors. Substantive specificity and unequivocality in authorization was important when the local officials justified their action to their superiors. On the other hand, when the local officials tried to appeal to the taxpayer's sense of shame in an attempt to induce compliance, they focused on the question of the form of law.

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214. There were also other legal advantages for the local officials to rely on a legislative provision instead of ministerial pronouncements as the basis against the taxpayer. Under the Administrative Litigation Law, courts shall decide cases on the basis of legislation, government regulations and local regulations. Administrative Litigation Law, *supra* note 19, art. 53. On the other hand, courts can only use ministerial rules as references, *id.*, art. 53. As ministerial rules have a lower status than legislation and government regulations in an administrative litigation proceeding, the taxpayer would have a better argument against the official decision if the latter was based solely on ministerial rules. Invoking ministerial rules alone might therefore encourage the taxpayer to bring administrative litigation. Some difficult questions may arise, however, from the officials' reliance on Article 2 of the CICTA instead of ministerial circulars as the basis for the taxpayer's violation. How should one explain that the ministerial pronouncements during the 1980s authorized the officials to impose the CICT on golf courses, but the CICTA as enacted in 1958 already imposed a liability on the golf course? How can one separate the issue of authorization for the official act from the issue of liability of the taxpayer? The answers to those questions are left for another day.

C. *Appeal to the Taxpayer's Self-interest*

The officials also tried to induce the taxpayer's compliance by appealing to self-interest and rationality. In their 1996 Request, the local tax officials sought approval from the SGAT for their decision holding the JV liable for Business Tax on overseas club membership fees. They then used the SGAT's 1997 Reply to induce the taxpayer's compliance. Although the SGAT's ex post facto ruling may not give rise to a sense of shame because it was not a publicly announced rule, using the SGAT's ruling could still appeal to the taxpayer's self-interest and rationality. In Chinese practice, after a decision by the state highest tax bureaucracy, a matter is considered authoritatively settled<sup>215</sup> and chances for reversal are practically nil.<sup>216</sup> If the taxpayer continues to resist, it does so at its own peril. Not only would nothing be changed, but moreover the fine for late payment continue to accrue daily.<sup>217</sup> If the taxpayer was rational, the SGAT's instruction would thus be expected to induce cooperation and compliance.

By spring 1997, the Local Taxation Bureau believed it had to show the coercive aspect of law in order to induce compliance. In April 1997, it seized Baori's motor vehicles and bank accounts and, when the taxpayer still failed to pay the full amount due, it auctioned off the vehicles the following month.<sup>218</sup> Technically speaking, the local tax authorities did not have to take piecemeal action against the property of the delinquent taxpayer; they could have seized all the property of the taxpayer to satisfy the government claim at once.<sup>219</sup> The April 1997 action was designed to show the seriousness of the local officials who still hoped that the Japanese

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215. For the practice of viewing the SGAT's instruction as authoritative, see the *Gulangyu Aquarium* tax case, *supra* note 93.

216. According to a comment on the *Gulangyu Aquarium* tax case, the SGAT's reply falls within the category of administrative interpretation, which can bind a people's court as a legal fact or evidence as long as the SGAT possesses the power to interpret the underlying legislation or regulations. 20 ANLIXUAN, *supra* note 93, at 333. In practice, cases in which courts overthrew administrative interpretation were unheard of. A court is not authorized to substitute its interpretation to the interpretation made by the competent administrative authorities. *See supra* note 19.

217. According to the 1992 Tax Collection Law, *Zhinajin* or penalty for late payment compounds at a daily rate of 0.2 percent. 1992 Tax Collection Law, *supra* note 3, art. 20. In *Baori*, as discussed before, the penalty for late payment against the JV totalled 52,527,000 million yuan from July 1, 1996 to August 18, 1997. Announcement on *Baori*, *supra* note 3, at 7.

218. *See supra* notes 74-75 and accompanying text.

219. 1992 Tax Collection Law, *supra* note 3, art. 27.

management would ultimately be persuaded to comply.<sup>220</sup> Only after it became clear that the Japanese investor was not going to change its mind did the Local Taxation Bureau decide to take a full-blown enforcement action.

Appealing to the taxpayer's sense of shame and appealing to its self-interest are thus not mutually exclusive. If the officials had difficulty in convincing the taxpayer that it had indeed violated a known rule, they could then turn to the instructions obtained from the SGAT to persuade the taxpayer that continued resistance to the official determination would be as futile as it was costly. Furthermore, after obtaining such instructions from the country's highest tax administrative authorities, the local tax officials could rest assured that they could safely weather any legal challenge, or at least, that their superiors would stand by them if their decision was questioned.

## VI. SEEKING A FAVORABLE OPINION: THE PUBLIC USE OF LAW

The enforcement action in April 1997 brought the case into the public spotlight. Official news media began to explain the case to the public in terms of law. Law in this context had "a broad, rhetoric sense"; it was "that which the [officials were] using to fight [violations]".<sup>221</sup> The slogan "administering tax according to law" enlisted support by telling the public that the officials relied on law to combat tax offenses. Popular backing could bring further pressure to bear upon the taxpayer and add justificatory force to the authorities' decisions and action.<sup>222</sup> In an interview published in the Shenzhen Taxation Bulletin - the official publication of the Shenzhen Local Taxation Bureau - (1997 Interview),<sup>223</sup> a senior local tax official opened his explanation of the case by quoting the legislative

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220. There was an assumption among many Chinese that as the club had brought profit to the Japanese investor, the Japanese side would like to keep the business to avoid official foreclosure action. It turned out, however, that the Japanese investor chose the officials' foreclosure action instead of paying all taxes and penalties.

221. Note, *supra* note 106, at 1902.

222. *Cheng Faguang*, *supra* note 91, at 4 (in the words of the Deputy Director of the SGAT, a mass of mail came from all over the country in support of the Shenzhen local tax officials' decision and praised their action as just).

223. 1997 Interview, *supra* note 14.

provision defining the offense of *toushui* or "tax evasion".<sup>224</sup> The interviewee further emphasized that the JV was even guilty of the offense of *kangshui* or "refusal to pay tax".<sup>225</sup> The 1997 Interview was a typical attempt to convince the public that the taxpayer was guilty of both charges beyond a doubt.<sup>226</sup>

Historically, the expression *toushui* or tax evasion has connoted capitalists' greed against the Chinese state and people. During the 1952 *Wufan Yundong* or "Five-Anti Campaign",<sup>227</sup> *toushui loushui*<sup>228</sup> or tax evasion was identified as one of the five evils of urban capitalists to be stamped out.<sup>229</sup> The Chinese Communist Party already had the political power and state machinery at its disposition, but urban capitalists continued to enjoy prestige and influence during the early years of the People's Republic.<sup>230</sup> The 1952 Five-Anti Campaign used mass mobilization and political campaigns<sup>231</sup> to discredit the urban bourgeoisie by exposing such

224. The interviewee quoted article 40 of the 1992 Tax Collection Law and explained that Baori committed *toushui* or "tax evasion" for its failure to record overseas membership fees in its accounting books and report them to the tax authorities. *Id.*, at 5.

225. *Id.*

226. In addition to official announcements and interviews the through mass media, the official message to the public also took such forms as organizing meetings or briefing sessions for the members of local trade associations or chamber of commerce. Shangguan, *supra* note 4, at 12.

227. For discussions of the Five-Anti Campaign, see A. DOAK BARNETT, COMMUNIST CHINA: THE EARLY YEARS 1949-1955 135-71 (1964); CHARLES P. CELL, REVOLUTION AT WORK: MOBILIZATION CAMPAIGNS IN CHINA 50 (1977); GODWIN C. CHU, RADICAL CHANGE THROUGH COMMUNICATION IN MAO'S CHINA 41-43 (1977); GORDON BENNETT, YUNDONG: MASS CAMPAIGNS IN CHINESE COMMUNIST LEADERSHIP 68-70 (1976); John Gardner, *The Wu-fan Campaign in Shanghai: A Study in the Consolidation of Urban Control*, in CHINESE COMMUNIST POLITICS IN ACTION 477-539 (A. Doak Barnett ed., 1969).

228. Prior to 1979, the expression *toushui* was used in tandem with another Chinese expression *loushui*. The latter literally means "tax leaks". In practice, there were no discernible distinction between the two terms, both being translated as tax evasion. The 1979 Criminal Law only mentioned *toushui* as a criminal offense. Criminal Law of the People's Republic of China (Zhonghua Renmin Gongheguo Xingfa) (1979 Criminal Law) (adopted on July 1, 1979), art. 121, 1979 FAGUI HUIBIAN 48, 74. Since then, *loushui* has been defined as failure to pay taxes due to a mistake or negligence, and is not criminally punishable. See, e.g., XINGFAXUE [JURISPRUDENCE OF CRIMINAL LAW] 394 (GAO MINGXUAN ED., 1982).

229. See, e.g., CELL, *supra* note 227, at 50. The other four evils were *xinghui* or bribery, *daopian guojia caichan* or theft of state property, *tougong jianliao* or cheating, and *daoqie jingji qingbao* or stealing of economic information.

230. Prior to the Five-Anti Campaign, Party policy generally accommodated to urban bourgeoisie who were then viewed as valuable and useful, at least for the time being, for the accomplishment of the Party's economic and other policy goals. For Party policy towards the urban bourgeoisie prior to the campaign, see Gardner, *supra* note 227, at 486-92.

231. During the 1952 Campaign, investigations into illegal activities were conducted by "audit teams, known as Tiger Beaters, . . . organized among Party members, professors, and college students to examine the books of factories and stores". CHU, *supra* note 227, at 42. A psychological warfare was launched and capitalists were bombarded by intensive propaganda and thereby forced



wicked acts as tax evasion.<sup>232</sup> *Toushui* consists of two Chinese characters or morphemes: *tou* and *shui*. While the latter means tax, the former *tou* is capable of more than one meaning. It can mean "doing things secretly" and, in that sense, *toushui* covers any surreptitious acts or attempts including the failure to disclose revenues or transactions subject to tax.<sup>233</sup>

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to confess wrongdoing whether or not they actually believed it. *Id.*, at 43. Urban private businesses were classified into five categories of establishments according to the amount of money they were found to have made illegally: law-abiding, basically law-abiding; semi law-abiding; serious law-breaking; and completely law-breaking. BARNETT, *supra* note 227, at 141. Quotas or targets were set as to how distribution should be made locally among the five categories, see Mao Zedong, *Guanyu Sanfan Wufan De Douzheng* [On the Three-Anti and Five-Anti Campaigns] (hereinafter Mao, *Three-Anti Campaigns*), Nov. 1951-Mar. 1952, MAO ZEDONG XUANJ DI WU JUAN [5 SELECTED WORKS OF MAO ZEDONG] 53, 55-56 (1977) (the first three categories should represent 95 percent of urban capitalists, and the last two should cover the remaining 5 percent. In Beijing, of fifty thousands capitalist establishments, 10 percent were law-abiding, 60 percent were basically law-abiding, 25 percent were semi law-abiding, 4 percent were serious law-breaking, and 1 percent were completely law-breaking.) Ad hoc peoples' tribunals were set up with members drawn from non-judicial organizations and the masses. Their functions were to arrest, try and punish serious law-breakers. Cases involving law-abiding, basically law-abiding, and semi law-abiding businesses were directly handled by special local Party committees. *Guanyu Wufan Yundong Zhong Chengli Renmin Fating De Guiding* [Regulations for the Establishment of People's Tribunals During the Five-Anti Campaigns] (adopted on March 21, 1952), in ZHONGGONGZHONGYANG WENXIAN YANJIU SHI [DOCUMENTS AND RESEARCH INSTITUTE, CHINESE COMMUNIST PARTY CENTRAL COMMITTEE], JIANGUO YILAI ZHONGYAO WENXIAN XUANBIAN DI SAN CE [3 COLLECTIONS OF IMPORTANT DOCUMENTS SINCE THE FOUNDING OF THE PEOPLE'S REPUBLIC] 125 (1992). Those who were found guilty were to be punished according a set of campaign-tailored principles: leniency for past violations, but severity for new violations; leniency for the majority, but severity for the minority; leniency for those who confessed, but severity for those who resisted; leniency for industrialists, but severity for merchants; and leniency for ordinary merchants, but severity for speculators. Mao, *Three-Anti Campaigns*, *supra*, at 55.

232. As an observer concluded, "[t]he campaign undermined the position of the urban bourgeoisie in China, greatly reduced its wealth and assets, ostracized it as dangerous and subversive, and probably eliminated any possibility of significant political influence on its part." BARNETT, *supra* note 227, at 143. After the Five-Anti Campaign, the state justifiably tightened its control over commerce and finance through measures such as forced state participation in private businesses, government contracts for basic goods and materials, and price controls. Meanwhile, the campaign achieved a significant revenue goal by diverting between 850 million and two billion US dollars worth of private assets to the state. CHU, *supra* note 227, at 43.

233. During the 1950s, the expression *toushui* was often used in tandem with another expression *loushui*, which literally means "tax leak". In 1950, the government of the new People's Republic adopted two major tax regimes. One was *huowushui* or a Commodity Tax which was imposed on the whole sale price of specified goods, Provisional Regulations on Commodity Tax (*Huowu Shui Zanxing Tiaoli*) (Regulations on Commodity Tax) (adopted on January 27, 1950, promulgated on January 31 of the same year, amended on December 15, 1990 and promulgated on December 29 of the same year), 1949-1950 FALING HUIBIAN 291. For a discussion of the tax, see ECKLUND, *supra* note 140, at 62-63. The other tax regime, broadly called *gongshangye shui* or Taxes on Industry and Commerce, consisted of two separately assessed taxes: an income or net receipts tax and a business or gross receipts tax. Regulations on Taxes on Commerce, *supra* note 141. For a discussion of the taxes, see ECKLUND, *supra* note 140 at 58-62. The Regulations on Commodity Tax authorized tax officials to impose fines and even confiscate goods in case *toushui*

The character *tou* also refers to the illicit act of theft or stealing. The expression *toushui* can therefore not only connote acts resulting in paying less tax, but also implies that avoiding tax would be equivalent to theft and stealing. In fact, three of the other four evils targeted by the Five-Anti Campaign were directly associated with the Chinese characters meaning "theft" and "stealing".<sup>234</sup>

In *Baori*, the *toushui* label seemed to perfectly fit the conduct of the Japanese investor as officially described. The Japanese investor not only took unfair advantage of the Chinese partner but also tried to cheat the Chinese state of tax revenue.<sup>235</sup> The label helped galvanize public opinion<sup>236</sup> and cast a social stigma on the Japanese management.<sup>237</sup> News reports quoted businesses and taxpayers as saying that they felt indignation at

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*loushui* was committed. Regulations on Commodity Tax, *supra*, art. 13. On the other hand, the Regulations on Taxes on Commerce made no mention of *toushui* and, instead, referred to *loushui*. Regulations on Taxes on Commerce, *supra* note 141, art. 25. The Regulations also identified *nibao yingye'er suode'er*, or concealment of gross receipts or income, and *weizao zhengju*, or falsifying evidence, as punishable acts, *id.* The statutory language suggested a difference between *toushui* and *loushui*: the former applied to goods, *see also* 3 ZHONGWEN DA CIDIAN [3 CHINESE DICTIONARY] 1143, 1145 (PUBLISHED BY ZHONGHUA WENHUA YANJIUSUO [CHINESE CULTURAL INSTITUTE], TAIBEI, 1963) (*toushui* originally describes "secret shipments of goods to avoid taxes"), and the latter could be used for violations of either the goods tax or taxes on industry and commerce.

234. The first Chinese character for *tougong jianliao* or cheating is the same as *toushui* or tax evasion. Together with other expressions used during the campaign, *toushui* became a catch-all word for "evading law" and "making illegal profit", evils associated with private businesses and their capitalist mentality. As Doak Barnett noted, during the Campaign,

"many of the 'crimes' of the businessmen, as defined by the Communists, had less to do with laws than with vague moral judgments proclaimed by the Communists. For persons who proceed from the premise that making a profit is exploitation, and therefore immoral, it is logical to conclude that 'large' profits are 'illegal' because they involve 'stealing from the people.'"

BARNETT, *supra* note 227, at 150. The 1952 Campaign gave *toushui* an expanded usage beyond its former confinement to goods as the expression and its connotation served well the political objective of leadership, namely, identifying urban capitalists with dishonesty and theft against the people to wipe out the social and moral influence they might wield.

235. The Chinese accused the Japanese investor of greed, He, *supra* note 14, at 27; Zhan Xuan, *Jingyingzhe Sanjie* [Three Warnings for Businesses], SHENZHEN FAZHIBAO [SHENZHEN LEGAL NEWS], Sep. 2, 1997, at 3.

236. See Cai, *supra* note 14 (Beijing students' reaction to the official charge against Baori); Wang & Wang, *supra* note 16 (reaction of other foreign invested golf courses and clubs in China); Wu Chunbin, *Baori Shui An De Sikao* [Reflection on the Baori Tax Case], SHENZHEN FAZHIBAO [SHENZHEN LEGAL DAILY], Sep. 14, 1997, at 2 (reader's reaction to Baori).

237. See, e.g., Wang & Wang, *supra* note 14 (other overseas investors characterized Baori's act as "outrageous" and "deserving punishment").

Baori's tax evasion since they themselves dutifully paid taxes.<sup>238</sup> The *toushui* charge demonized the greedy foreign investor just as it had the evil capitalists during the Five-Anti Campaign forty-five years ago.

The Local Taxation Bureau added the charge of *kangshui* or "refusal to pay tax" after the case went public. *Kangshui*, which literally means resisting tax, also has deep historical roots. Rural rebellions occurring throughout the history of Imperial China traced their causes one way or another to government exaction of tax.<sup>239</sup> Peasants burdened by excessive taxes and levies were forced to organize protests as a last resort, which often turned violent.<sup>240</sup> A tax revolt was the single gravest act the people could commit against the state taxing power. The cost of *kangshui* to the state was translated not only in the form of losses in revenue collection but also in terms of military mobilization cost to put down revolts. In a *kangshui* event, the officials were personally faced with the danger of popular hostility, finding themselves in the middle of an angry name-calling crowd which threatened them with physical harm. In addition to physical harm and threats, tax revolts demonstrated popular defiance of the authorities which could spread quickly. Thus, although Confucian ideology exalted official sincerity and compassion in dealing with popular tax discontents, officials too often simply resorted to bloody suppression on the grounds that tax resistance was instigated by some vile trouble makers.<sup>241</sup> Even today, the image and consequences associated with *kangshui* are just too frightening and officials tend to believe that they must resort to whatever means necessary to quickly contain an event of *kangshui* before it can spread and be emulated by others.<sup>242</sup>

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238. He, *supra* note 14, at 27 (citing Hong Kong investors in Shenzhen); Wang & Wang, *supra* note 14 (citing golf courses and clubs in Yangtze Delta area).

239. As a historian noted, "[e]vidence of high taxes and excessive corvée duty was in fact present in almost all early stages of rebellion and was usually claimed to be the direct cause of an uprising". Kao Yu-Kung, *A Study of the Fang La Rebellion*, 23 HARV. J. ASIATIC STUD. 17, 18 (1960-1961). See also Wang Yu-Ch'uan, *The Rise of Land Tax and the Fall of Dynasties in Chinese History*, 6 PAC. AFF. 201 (1936).

240. For a detailed account of a violent tax protest in Sichuan Province during the 1870s, see Zhou, *supra* note 233. For other case studies of Chinese tax revolts, see Elizabeth J. Perry, *Tax Revolt in Late Qing China: The Small Swords of Shanghai and Liu Depei of Shandong*, 6 LATE IMPERIAL CHINA, 83 (1985); Lucien Bianco, *Peasant Uprisings Against Poppy tax Collection in Su Xian and Lingbi (Anhui) in 1932*, REPUBLICAN CHINA, Nov. 1995, at 93.

241. That was the position, for instance, of local officials handling the Sichuan Tax Revolt in the 1870s. Zhou, *supra* note 203, at 432-34. See also Bianco, *supra* note 240, at 105 (officials in charge found no choice but to fight rebels just to save their own rule).

242. Qiao Shi, a top Party official in charge of the country's law enforcement during the 1980s, reacted promptly after reading a report on assaults on tax officials, and wrote to law enforcement agencies to protect tax officials and severely punish ruffians who committed the offenses of resisting

Though the country's legislation incorporated the change of *kangshui* against foreign business, foreign businesses for domestic political reasons,<sup>243</sup> the actual use of the charge against foreign businesses was

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tax and assaults. *Zhonggong Zhongyang Zhengzhiju Weiyuan Zhongyang Zhengfa Weiyuanhui Shuji Qi Shi Guanyu Baohu Shuiwu Ganbu Yifa Zhishui Yancheng Kangshui Fanzui Fenzi De Pishi* [Reply of Qi Shi, Member of the Politburo of the Chinese Communist Party Central Committee and Secretary of the Political and Legal Commission of the Chinese Communist Party Central Committee, Concerning Protection of Tax Cadres in The Course of Their Collection of Taxes According to Law and Severe Punishment of Offenders of Tax Resistance], SHUISHOU GONGZUO WENXIAN HUIBIAN [COLLECTED TAXATION DOCUMENTS], 13 (1993). The concept of *kangshui* can be confused with another expression: *qianshui* or arrears with tax payment. When a taxpayer "fail[ed] to pay taxes on time by the deadline set by tax authorities and fell behind in tax payment schedule", the case was initially labelled *qianshui* or arrears with tax payment. Interpretation of Tax Evasion, Refusal to Pay Taxes, Tax Dodges and Arrears in Tax Payment by the General Taxation Bureau of the Ministry of Finance (hereinafter 1981 Interpretation), May 15, 1981, COMMERCIAL LAWS & BUSINESS REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA 203, 203 (Victor F.S. Sit ed., 1983). If subsequent official collection efforts were unsuccessful, the case could then turn into one of *kangshui*. In 1950, for instance, some businesses in the City of Wuhan failed to pay taxes on time on a mistaken belief that the government intended to reduce taxes; the authorities then issued warnings that if those businesses continued refusing to pay taxes, they would face enforcement measures against their assets and their wrongdoing would be publicly exposed. 1 LIU ET AL, *supra* note 146, at 170. In this case, the initial failure to pay tax looked like *qianshui* or arrears with tax payment whereas the continued failure to pay tax would be definitely treated as *kangshui*.

243. See, e.g., FEITL, *supra* note 52, art. 15. Interestingly, the 1991 UTL no longer uses the expression *kangshui* at all; although article 25 of the UTL continues to subject taxpayers who have failed to pay taxes after official notification to administrative and criminal penalties. UTL, *supra* note 53, art. 25. Meanwhile, *kangshui* remains a criminal offense. 1979 Criminal Law, *supra* note 228, art. 121. *Kangshui* remains an administratively punishable offense in the 1992 Tax Collection Law. 1992 Tax Collection Law, *supra* note 3, art. 45. Meanwhile the meaning of *kangshui* underwent change. The 1982 Implementing Rules for FEITL defined *kangshui* as "illegal actions of a taxpayer who has disobeyed the provisions of the Tax Law, such as by refusing to file tax returns, or to provide tax payment documentation, invoices or vouchers; refusing to accept investigations by the tax authorities of its financial, accounting and tax affairs; or refusing to pay tax or fines in accordance with the law". 1982 Implementing Rules for FEITL, *supra* note 55, art. 45. This definition followed a 1981 Ministry of Finance Circular which described *kangshui* as "illegal acts of taxpaying units or individuals in refusing to carry out the obligation of paying taxes according to the provisions of tax law." 1981 Interpretation, *supra* note 242. Examples of *kangshui* included a "refusal to pay taxes according to provisions of tax law; resorting to various pretexts to ignore the notice to pay tax of tax authorities and refusal to pay tax; refusal to file tax returns and provide tax payment data according to the legal procedures; resisting checks on tax payment by tax authorities according to law; inciting people to make trouble, threaten or besiege tax offices and beat up tax workers, etc." *Id.* A March 1992 document jointly issued by the Supreme People's Court and Supreme People's Procuratorate adopted a similar definition and examples for *kangshui*. Notice of the Supreme People's Court and Supreme People's Procuratorate for Issuing The Explanations Concerning Some Issues of Application of Law in Handling Criminal Cases of Toudouhui or Tax Evasion or *kangshui* or Resisting Tax (Zugao Renmin Fayuan Zugao Renmin Jianchayuan Yinfu Guanyu Banli Toudouhui Kangshui Xingshi Anjian Juti Shiyong Falu De Ruogan Wenti De Jieshi De Tongzhi) (March 1992 Document), Mar. 16, 1992 SHUISHOU GONGZUO WENXIAN HUIBIAN [COLLECTED TAXATION DOCUMENTS], 2106 (1993). The examples of *kangshui* given in the March 1992 Document included "protracting the period of tax arrears with various excuses." *Id.* Until March 1992, the offense of *kangshui* was not limited to the cases where violence or threats of

unheard of prior to the *Baori* case. The assumption was that foreign businesses were highly unlikely to threaten Chinese tax officials physical harm,<sup>244</sup> a major concern underlying the *kangshui* charge. Furthermore, as *kangshui* implied an anti-Chinese state predisposition of the taxpayer, it would not be applicable to foreign investors whom the Chinese government treated as friends contributing to the country's modernization drive.<sup>245</sup> *Baori* appears to be the first case in which the *kangshui* charge was publicly levelled against a foreign investment enterprise. The *kangshui* charge indicated Chinese anger and disbelief. The charge was explicitly premised on the authorities' claims, that during a lengthy period of four years, the JV's Japanese management repeatedly and defiantly refused to pay the tax due; spread rumours defaming the local authorities, obstructed tax enforcement, and threatened to embarrass the authorities with hints of official corruption.<sup>246</sup> Other evidence of defiance included the fact that the Japanese management disparaged the authoritativeness of the

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violence were used; a passive act of delaying tax payment might suffice as *kangshui*. Shortly after the March 1992 Document was issued, however, the Chinese legislature adopted the 1992 Tax Collection Law and 1992 Supplementary Provisions which both appear to limit the *kangshui* charge to cases where taxpayers refuse to pay taxes by using either violence or threats. 1992 Tax Collection Law, *supra* note 3, art. 45; 1992 Supplementary Provisions, *supra* note 8. As one authority stated, the definition adopted by the 1992 Tax Collection Law and Supplementary Provisions effectively overrode the March 1992 document as the latter did not require use of violence or threats in a *kangshui* case. ZHOU DAOLUAN, DANXING XINGFA YU SIFA SHIYONG [SUPPLEMENTARY CRIMINAL LAWS AND JUDICIAL APPLICATION] 322-23 (1996) (hereinafter ZHOU DAOLUN). The word "threats" has been understood broadly, however, to include any communicated intent or declaration of the purpose to work injury to the physical well-being of tax officials or their family members or to their reputation or property. *Id.*, at 321.

244. Use of violence or threats against tax collectors was officially denounced not only as illegal but even barbarian and uncivilized behavior. Thus, the charge of *kangshui* has been used selectively in Chinese tax statutes. It appeared in some statutes in the early 1950s, *see, e.g.*, Provisional Regulations on Goods Tax (Guowu Shui Zhanxing Tiaoli), art. 13 (adopted on January 27, 1950), 1949-1950 FALING HUIBIAN 291, 297; 1950 Regulations on Taxes on Commerce, *supra* note 141, art. 24. The CICTA, *supra* note 51, contained no provision, however, on the charge of *kangshui*. *Kangshui* was likely committed by uneducated individual taxpayers such as small merchants. As private businesses were transformed into state or collectively owned enterprises by the late 1950s, *kangshui* should no longer be a serious concern. Overseas investors were expected to possess advanced technology and expertise and therefore act in a civilized manner when dealing with Chinese officials.

245. For a discussion of the Chinese friendship and relational approach to foreign investment, *see* Jiang, *supra* note 40, at 628-33. The Chinese were accurately aware of the profit motivation of foreign businesses, *id.*, at 605-6, 610. In the eyes of many Chinese, foreign capitalists might be greedy enough to commit tax evasion, but they were unlikely to dare to challenge the state authorities.

246. 1997 Interview, *supra* note 14, at 5. There were also allegations that the local tax officials and their family members were facing some kind of physical threats at one point during the investigation. Shangguan, *supra* note 4, at 11.

1996 Reply and accused the SGAT of violating the foreign investor's property rights.<sup>247</sup>

To the ordinary Chinese, the message contained in the official charge of *kangshui* was clear: the Japanese investor in *Baori* was no longer a friendly foreign business deserving cordial gestures and friendship. The case was no longer confined to the issue of economic greed, but also involved hostility toward the Chinese state and people. While the *kangshui* charge brought no extra revenue to the government in *Baori*, it signified that the case had reached a higher degree of political seriousness. It would also facilitate criminal prosecution against the individuals responsible for the JV's refusal to cooperate.<sup>248</sup> In addition, by appealing to the concern that other foreign businesses might follow suit,<sup>249</sup> the *kangshui* charge further justified official enforcement measures.<sup>250</sup> As *kangshui* caused fear, the people all across the country would sympathize with those working in the *Baori* case.<sup>251</sup> Thus, no sanction would look too severe in making an example of the Japanese investor in the case.

The official rhetoric also exploited popular moral indignation against the Japanese investor in *Baori*, which had accumulated almost one billion yuan from overseas club membership fee collections, while paying no tax to the Chinese state treasury.<sup>252</sup> The Chinese policy promoting foreign investment through preferential treatment assumed that foreign investors

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247. Announcement on *Baori*, *supra* note 3, at 5.

248. Since violence or threats can be committed only by natural persons in contrast to corporate entities, the general understanding is that individuals, not enterprises, may be charged with the offense. ZHOU DAOLUN, *supra* note 243, at 322. In *Baori*, although the Local Taxation Bureau apparently charged the JV, an enterprise, with *kangshui*, the charge was intended to pave the way for criminal investigations and prosecution against those individuals in the JV management who were responsible for resisting the official decision in the case.

249. The Director of the Local Taxation Bureau made it clear that, faced with the Japanese management's non-cooperation and hostility, the authorities had no choice but to pursue the case; otherwise some other foreign investment enterprises might follow the *Baori* example. Shangguan, *supra* note 4, at 12. Because *kangshui* had not been directly to foreign businesses before, Chinese officials might have feared that a wrong message could spread if *Baori* or its Japanese investor were not severely punished.

250. 1997 Interview, *supra* note 14, at 5.

251. See Guo Limin, *Tou Pian Qian Shui Heshi Neng Zhizhi* [When Can Tax Evasion, Tax Cheat and Tax Delinquency be Stopped], SHEWAI SHUIWU [INTERNATIONAL TAXATION IN CHINA], 1997 No. 11, at 46, 47 (praised Shenzhen local tax officials for their bravery and self-sacrifice in investigating the *Baori* case).

252. A deputy mayor of Shenzhen stated that the Chinese state provided numerous benefits to foreign investors and, as a result, foreign businesses had a reciprocation duty to pay taxes. *Municipal Government Expresses Its Support*, *supra* note 90. College students in Beijing condemned *Baori* on the moral ground that the JV benefited from preferential tax treatment and improvement of investment conditions in the country. Cai, *supra* note 14.

would sooner or later contribute to the country's development.<sup>253</sup> After foreign businesses received tax and non-tax preferences (lax enforcement of tax law was in fact a favor), they were expected to reciprocate by helping the Chinese technologically or financially. As the golf club in *Baori* offered no advanced technology, financial contribution in the form of taxes was thus the only way to repay the Chinese state.

The public was reminded of the benefits the official decision and action against *Baori* would bring to the state as well as to the city of Shenzhen. According to the 1997 Interview, tough law enforcement not only enabled the city government to gain financial resources and improve the infrastructure for business in the city, but also contributed to fair competition among businesses.<sup>254</sup> The official message also targeted the foreign business community. After stating that Shenzhen was hosting fourteen thousand foreign investment enterprises including two hundred Japanese investment projects, the 1997 Interview praised the majority of foreign businesses in the city as law-abiding and taxpaying.<sup>255</sup> It further asserted that punishing tax violators like the Japanese investor in *Baori* would contribute to the improvement of investment conditions in Shenzhen as the city would have more money to spend for building infrastructure.<sup>256</sup> The interviewee claimed that the way the *Baori* case was handled demonstrated the local officials' commitment to the idea of law, another indication of improved investment conditions in Shenzhen.<sup>257</sup> The Local Taxation Bureau reportedly received many letters of support from taxpayers including foreign business people.<sup>258</sup>

The *toushui* and *kangshui* charges not only invoked memories and fears among the public but also identified the heroes and the villain. The tax officials in Shenzhen were touted as defenders of the state and people's interest whereas the Japanese investor was painted as a greedy, defiant and dangerous element. The "good guys" should get public acclaim for their deeds in the instant case and also deserved support in future fights against

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253. See Jiang, *supra* note 40, at 620-21, 622, 628-30..

254. 1997 Interview, *supra* note 14, at 7.

255. *Id.* The *kangshui* charge in fact differentiated between the Japanese investor in *Baori* and other foreign businesses in the city; while the former became an enemy, the other foreign investors remain friends of China.

256. *Id.*

257. *Id.*

258. *Id.*

tax evasion.<sup>259</sup> In contrast, the villain should be punished and anyone committing tax violations in the future should be subject to similar condemnation and sanction as well. At the same time, the *Baori* case taught businesses all over the country a valuable lesson concerning their law abiding and tax-paying duties.<sup>260</sup>

## VII. CONCLUSION

The trilogy of the use of law in *Baori* reveals several basic features of Chinese law. Law remains mixed with government administration in general. The legal discourse in China is inherently hierarchical. One's position in the country's political and administrative hierarchy determines his place in the country's legal order. Between a superior and his subordinate officials, law is what the former does to direct and control the act of the latter. Between officials and the public, the former enjoy respect and deference, while the latter has a duty to obey commands. Yet, while the concept of law in China is authoritarian by nature, its use is also heavily influenced by tradition and ideology. Although law is routinely invoked to justify punishment, it is also evidence of morality as well as an indispensable tool for education and persuasion. Thus, official coercion should thus usually be avoided. The officials should make their relationship with the public appear as harmonious as possible. If coercion is necessary against individual taxpayers, the authorities need the support of favorable public opinion by isolating such violators from the mass of taxpayers.

Chinese law entertains both the idea of permanence and that of flexibility. As law identifies with the ruler's political authority as well as the power of tradition, its principles and tenets should be enshrined in

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259. The *Baori* case was reported to have caused a rise in tip-offs about tax evasions in Shenzhen. *Shenzhen Chachu Baori Shui An Yingxiang Da* [Shenzhen's Handling of the Baori Tax Case Has Had a Big Impact], *ZHONGGUO SHUIWU BAO* [CHINA TAXATION NEWS], Aug. 11, 1997, at 1 (hereinafter *Big Impact*).

260. See *Analysis About Baori*, *supra* note 14, at 8 (all investors should be law-abiding); Zhan, *supra* note 235 (*Baori* as a lesson for all businesses); Wu, *supra* note 236 (*Baori* as a lesson for the masses). In fact, there were reports that the *Baori* case already had a very positive impact on the self-consciousness of taxpayers to pay tax. *Big Impact*, *supra* note 259 (the chairman of the board of directors of a Japanese investment enterprise in Shenzhen, after hearing about the *Baori* case, reportedly held an emergency meeting with his financial managers and, as result, the enterprise voluntarily paid over 1.6 million yuan in overdue taxes for the past three years plus fines for late payment).



permanent forms. Dynastic codes were the dominant permanent forms in the past. Intensified legislative efforts in the last twenty years are testimony to the recent revival of the idea of permanence. Meanwhile, law as the tool of government administration must be flexible enough to accommodate the changing agendas of the leadership as well as the varying circumstances of particular cases. In imperial China, the court's edicts and rescripts which supplemented or even revised code provisions exemplified the law's flexibility. Since 1949, the political demand for flexibility has increased as Party policy undergoes constant changes. For many years, the country was largely governed by leaders' words, superiors' directives and ad hoc rules with few or no formal legislation. Post-Mao leaders have stressed the role of legislation; but legislative enactment is usually worded in general and open-ended language. Its operation is made dependent on interpretation and the implementation policy of relevant officials. Overall, so far as law implementation is concerned, flexibility prevails over the idea of permanence. As the fate of the Japanese investor in *Baori* has shown, while law as formally written may remain the same, enforcement can vary depending on the controlling policy agendas.

The use of law in *Baori* further illustrates the dual forms of communication in law that exist in China. One is the internal form of communication between the local tax officials and their superiors. The local tax officials relied on channels for reporting and requests for instruction to seek their superiors' understanding and support. In turn, the superior officials issued instructions and directives on points of law and policy.<sup>261</sup> While internal communication channels were highly relevant to understanding the inner workings of the official process, those reports, requests, instructions and directives were mostly kept out of sight for the public view and were not even fully disclosed to the taxpayer in question. On the other hand, there are open and publicly accessible channels of communication through which the taxpayer and members of the public are selectively given messages and information.<sup>262</sup> The two forms of

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261. The local tax officials reportedly submitted over 50 written reports to municipal, provincial and national superiors, explaining their views and analyses, and in turn received numerous replies and instructions from above. Shangguan, *supra* note 4, at 12.

262. It appears that legal and policy issues which were officially deemed sensitive or unnecessary for public consumption were never discussed openly. For instance, the local tax officials asked for clarification of certain legal questions regarding tax administration in a 1997 request to the SGAT; the contents of the request and the subsequent reply by the SGAT were not made public, apparently because they dealt with technical points which served no persuasion or education purposes to the public.

communication serve distinct purposes. Internal communication channels allow the local tax officials to freely express their views and articulate their positions while preventing the taxpayer and others from using such information to contradict and embarrass the authorities. Meanwhile, the superior officials can depend on internal channels to protect their decisions from direct attack by the taxpayer. By hiding exchanges between the superior and subordinate officials from the public eye, the internal form of communication contributes to the image of a modern government which is based only on the objectivity of law, not the subjectivity of superior officials. The message transmitted through internal channels is both technical and policy-sensitive. On the other hand, the open form of communication which includes mass media and other generally available channels of information sent a moral message to the taxpayer and the public. There was no need for a technical discussion as to whether the taxpayer committed tax offenses or which rule it violated. The taxpayer's guilt of wrongdoing was assumed beyond any question. Rather, the message in the mass media drew attention to the question as to what the taxpayer ought to do and how the public should react. The answers were obvious: the delinquent taxpayer should repent by complying with the official decision and the public should condemn such law violations. Thus, the message was more a morality play than an explanation based on reasoning.

*Baori* also brought to light the practice of using different forms of law for different purposes. A publicly announced form of law such as legislation can appeal to the taxpayer's sense of shame, but may not be specific enough to be relied upon to justify the lower officials' decision to the superiors. On the other hand, a circular for internal use can provide perfect authorization as it contains the precise and unequivocal rule pertaining to the issue at hand. It may not be appropriate, however, for appealing to the taxpayer's sense of shame as it was not publicly announced. The use of law thus acquires a ritual significance. Law's form can be at least as important as its substantive content.

The Chinese Community Party has proposed a conception of the rule of law to be incorporated in the country's Constitution.<sup>263</sup> As *Baori* has shown, certain features of Chinese law work to place constraints on officials. But other features such as the identity between law and administrative commands and the hierarchical nature of the legal discourse

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263. See Ian Johnson, *Beijing Moves to Help Private Enterprise*, ASIAN WALL ST. J., Feb. 1, 1999, at 1, 5 (constitutional amendment to require the government to "use laws to rule the country").

indicate that ordinary people have no meaningful right to challenge official acts. While low officials are subject to law's rituals, high officials are generally safe from its scrutiny. The dual forms of communication further alienate the people from the country's political, legal and administrative process. Although tradition, moral beliefs and ideology operate to moderate the harsh side of law and government and have been in fact incorporated into law to some extent, law's flexibility continues to make official action uneven and unpredictable. While the concept of the rule of law thus requires the people and lower officials to conform their conduct based on what is called "law", the substantive content of "law" falls within the power of the leaders and other high ranking officials.

