

Leveling the Playfield of Enterprise Competition in China

—The Review on China's New Unified Enterprise Income Tax Law (outline)

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Since early 1990s there have been coexisting two sets of enterprise income tax systems in the People's Republic of China. One of the two sets of enterprise income tax systems is the so-called domestic invested enterprise income tax system which is in principle based on the **Provisional Regulations of the People's Republic of China on Enterprise Income Tax (PREIT)** of the year 1993, the other is the foreign invested enterprise income tax system which is principally built by the **Income Tax Law of the People's Republic of China on the Enterprises with Foreign Investment and Foreign Enterprises (ITLEIFE)** of the year 1991. On March 16 of this year, China's parliament, the National People's Congress, adopted the landmark law, the **Enterprise Income Tax Law of the People's Republic of China (EITL)** which is due to come into effect as of January 1st, 2008 .

I. the Four Reform Features of the EITL

Compared with the current two sets of income tax systems, the content of provisions of China's new unified enterprise income tax law reflects **four features** of the reform of current enterprise income tax systems in China as follows:

1. Promotion of the principles of tax equality and fair competition

This feature is reflected by the four concrete examples: 1) the unification of legal provisions on the items of the pre-tax deduction and deduction standard; 2) the unification of legal provisions on the enterprises taxable income items, the depreciation of fixed assets, the amortization of the intangible assets, long-term prepaid expenses and the valuation method of stock , and etc.; 3) the reform of tax incentives and the unification of tax rate at 25%; and 4) the extension of foreign tax credit to the taxable income derived by the foreign enterprises having establishments or places in China.

2. Normalizing the enterprise income tax system with reference to international tax usages

This feature can be shown in four aspects: 1) redefinition of the taxpayers of enterprise income tax; 2) categorization of the taxpayers in reference to international tax practice; 3) changes in the administration of income tax collection; and 4) incorporation of the rules on indirect foreign tax credit.

3. Reform of the tax preferences

The changes in tax preference in the EITL can be briefly summarized into four aspects: 1) Many indirect tax preferences are introduced into the **EITL**; 2) Industry-based tax incentives are replacing the region-based tax incentives as the mainstay in the tax preferences; 3) The tax preferential policies in the EITL are crafted to promote enterprise innovation and technological development as well as the environmental protection, the energy conservation and the work safety; 4) The concerns of public welfare and the needs to support the disadvantaged are taken in account in making the tax preferential policies.

4. Strengthening the regulation on tax avoidance tax

The **EITL** contains five major changes in strengthening the regulation on tax avoidance: 1) New regulatory measures are adopted including the cost sharing agreement and the advance pricing arrangements. 2) The powers of supervision and control of tax authorities over tax avoidance are strengthened. 3) A general anti-avoidance rule, i.e. the principle of “reasonable business purpose”, has been added into the **EITL**. 4) The **EITL** introduces the controlled foreign company (CFC) rules (Art. 45). 5) Thin capitalization rules are adopted in the **EITL**.

: II. The Four Remained Problems in the EITL

In the authors' opinions, there are at least four issues in the **EITL** that need further clarification. These issues are concerned with: 1) the definition of taxpayers; 2) non-deductible expenses in the calculation of the taxable income; 3) tax exemption on certain income from equity investment; 4) relationship between the bilateral tax treaties and the **EITL**.