

CHINESE LAW

TAXATION AND CONSTITUTIONALISM IN CHINA



Xu Yan*

The current problems of China's taxation system reveal a major flaw in its Constitution and reflect a false understanding about taxation maxims. This article points out, through analysing three major problems with respect to its income taxes, that one of the main reasons that many businesses and common citizens throughout the country are reluctant to pay taxes is that they enjoy few rights as taxpayers. According to modern constitutional theory and tax law theory, taxpayers' rights not only concern people's private property rights but relate, also, to their civil and political rights. Few Chinese constitutional scholars pay sufficient attention to the fact that limiting government is a pre-requisite to foster growth in constitutionalism. This article discusses the linkage between taxpayers' rights and constitutionalism and suggests some reforms aimed at fostering the growth of limited government in China.

Introduction

Unlike in western developed countries, ordinary citizens in China¹ generally have no sense of being taxpayers. It is a rather common phenomenon throughout the whole country that businesses and citizens make great efforts to avoid paying their income taxes or commit tax evasion. On the other hand, common citizens, especially workers or labourers making a living on their monthly salaries, as well as farmers in the countryside, have in fact suffered grievously from heavy tax burdens and other kinds of non-tax fees imposed by different government agencies or local governments, but they remain unaware that they are entitled to ask for government services.

When we look at the reality of today's China, the government's behaviour is unsatisfactory in many aspects, even though the country and its government have decided that "The People's Republic of China governs the country

* MPhil (Master of Philosophy) candidate, Department of Law, University of Hong Kong. The author wishes to express her profound appreciation of the steadfast support of her supervisor, Dr Fu Hualing. She also gratefully acknowledges the generous help of Professor Richard Cullen, who introduced to her many resources for this research. Thanks are due to the anonymous reviewer, whose comments have helped to revise some areas.

¹ From the point of view of Beijing, the People's Republic of China has four jurisdictions, ie, the Mainland, Hong Kong, Macao and Taiwan. Their legal systems are different and the relationship between the Mainland and the other three is complicated, especially with Taiwan. This article is focused on the Mainland and its problems.

according to law and makes it a socialist country ruled by law.”² The truth, however, is that the government power and actions do not meet the requirements of the “rule of law”.³ Three major problems are as follows. First, the government’s power has been expanding to the extent that it enables itself not only go beyond the limits of laws by way of delegated legislation, but also frequently to interfere with judicial adjudication, not to mention *ultra vires* administrative acts it takes and arbitrary uses of its discretionary power. Second, the government budget is too unclear to know its details and not accessible to the public, and the power to impose taxes is ineffectively controlled by laws, causing severe corruption amongst government officials at many levels. This inevitably prevents the state from achieving the “rule of law”. It also greatly damages common citizens’ private property rights and it disturbs market autonomy. Third, basic human rights protection is far from sufficient. The big gap between poor and rich has become a more severe social problem than ever before. Severe problems exist with respect to the quality and quantity of government services.

On the surface, these two facts – people’s tax evasion and unbridled government – have little close linkage. But from the perspective of the constitutional theory that tax constrains a government’s fiscal power, a direct connection between the two may actually exist. How to progress toward a limited government in China is a difficult question. Many politicians and legal scholars have put forward some suggestions, such as via the “political method”⁴ or the “cultural way”,⁵ but unfortunately, these solutions cannot

² The new paragraph was added to Article 5 of the Constitution as the first paragraph in the Amendment of the Standing Committee of the National People’s Congress (SCNPC) to the Constitution of the People’s Republic of China on 15 March 1999.

³ “Rule of law”, as many scholars have argued, is an “essentially contested concept”. Randall Peerenboom categorised it into two types: thin and thick. He explained that “[a] thin theory stresses the formal or instrumental aspects of rule of law”; “a thin rule of law requires procedural rules for law-making and laws must be made by an entity with the authority to make laws in accordance with such rules to be valid; and “a thin rule of law requires publicly promulgated laws, knowable in advance, that are generally prospective rather than retroactive, relatively clear, consistent, with other laws, and subject to rapid changes”. In contrast to thin versions, thick or substantive conceptions begin with the basic elements of a thin concept of rule of law but then incorporate elements of political morality such as particular economic arrangements (free-market capitalism, central planning, etc), forms of government (democratic, single party socialism, etc), or conceptions of human rights (liberal, communitarian, “Asian values”, etc). Peerenboom maintains that contemporary China “is in the midst of a transition toward some version of rule of law that measures up favourably to the requirements of a thin theory. See Randall Peerenboom, *China’s Long March toward Rule of Law* (Cambridge: Cambridge University Press, 2002), pp 3, 6.

⁴ For instance, Mao Zedong, the first Chairman of the People’s Republic of China, maintained that the basic way to constitutionalism is “revolution”. See Mao Zedong, “Xin Min Zhu Zhu Yi Xian Zheng [New Democratic Constitutionalism]” in *Mao Zedong Xuan Ji [Selections of Mao Zedong]* (Beijing: Renmin Press, 1991), Vol II, p 732.

⁵ For example, Wang Renbo indicated that the western constitutionalism was born on the basis of its cultural traditions and was the natural outcome of its social and cultural evolutionary development. To the contrary, China does lack a genuinely mature cultural basis for such a type of constitutionalism, though it contemporarily introduced western constitutional theories and thoughts to its legal and social systems. See Wang Renbo, *Xian Zheng De Zhong Guo Zhi Dao [The China’s Way to Constitutionalism]* (Jinan: Shan Dong People’s Press, 2003), pp 1–22.

satisfactorily answer the question. This article maintains that by drawing on the constitutional meaning of taxation and the legal systems used to impose taxation, certain essential, promising steps might be taken to help China build a limited government in accordance with the “rule of law”.

Tax Theory and the Right to Tax

In a constitutionalised polity, the government's power to tax is not endowed with the birth of the state, but derives ultimately from the private property rights owned by common citizens.⁶ For citizens, it is the most familiar manifestation of the government's power to coerce. The power to tax is in itself the power to “take”. Basically, there are two ways for the government to obtain a particular piece or share of private property from a citizen. One is by direct appropriation, and the other is by a tax imposed on the original owner.⁷ For the former, such taking is nothing but “plunder”. If it were not for the government's coercive power, the citizen would not voluntarily agree to allow the government to take his or her property with no benefit. In this setting, there exists no constitution; even if the government were a benevolent despot, promising to act in accordance with the will of all citizens, there would be no logical basis for a constitution.⁸

⁶ From a constitutional perspective, a government derives its powers from the ultimate consent of those who are governed. The power to tax is one example of such a power. It is implied that the authorised agent of coercion, the government, may be limited in its range of action by a constitution. See Geoffrey Brennan and James M. Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge: Cambridge University Press, 1980), pp 1–2. Another research work incorporated basic elements from the version presented in the works of James Buchanan. It argued, through clarifying its normative base and core idea for constitutional choice, that the normative basis for the contractarian enterprise is unanimous agreement among individuals. This basis follows directly from the central notions of methodological and normative individualism, the latter of which can be motivated on epistemological grounds or because the individual is, quite simply, seen as the ultimate sovereign in matters of social organization. See Niclas Berggren, “Social Order through Constitutional Choice: A Contractarian Proposal” in Niclas Berggren, *Essays in Constitutional Economics* (Stockholm, Sweden: Economic Research Institutes, Stockholm School of Economics, 1997), pp 16–19. There, certainly, may be different views on this issue, the original source of government powers. Those who criticise the Buchanan view take a range of differing views. This article does not attempt to discuss these debates at length since it would distract attention from its main purposes. The article is, in the main, adopting the Buchanan view. It agrees with him on the point that the power to tax is ultimately drawn from the consent of citizens. As to what kinds of consent it obtains and by what rules it obtains consent, these are not this article's main concerns.

⁷ Sometimes a government may also purchase property outright rather than taxing it (or simply taking it). When, in this case, a government pays less than the market price, it is in part, at least, appropriating or taking property, once more.

⁸ As Buchanan has argued, a constitution is a set of rules for meeting the need to constrain the power of government. He modelled government as a revenue-maximising Leviathan rather than a benevolent despot. “The logic of constitutional restrictions is embodied in the implicit prediction that any power assigned to government may be, over some ranges and on some occasions, exercised in ways that are at variance with the desired usage of such power, as defined by citizens behind the veil of ignorance.” Brennan and Buchanan (n 6 above), pp 1–9.

For a constitution to apply, therefore, there must be some distinction between taking and taxing: the tax must involve certain extra requirements that are otherwise not present with direct appropriation. It turns out to be a problem of rationalization of the government's possession of the power to tax. This power is allowed by rational taxpayer-citizens only for the purpose that taxes can be predicted to be used for financing public goods or transfers that taxpayer-citizens desire. Citizens hope to limit the exercise of government powers so as to ensure that outcomes fall within tolerable bounds. This is the logical basis for a constitution. In this sense, the power to tax is on the premise that citizens' private property exists ahead of the birth of a state; the private property right is the predetermined constraint on government powers.⁹

It is in this sense that Schumpeter says that: "Taxes not only helped to create the state. They helped to form it. The tax system was the organ the development of which entailed the other organs."¹⁰ Tax also serves as an intermediate means of transforming private property into public property. Since taxation is so fundamentally related to the concept of private property, a modern (non-coercive) constitution must impose constraints on the power to tax, restricting the ability of government to take actions that would not be desirable for taxpayer-citizens.

The 14 March 2004 Amendment to the Constitution¹¹ of the PRC takes a step in this direction by admitting the nature and importance of private property rights:

"Citizens' lawful private property is inviolable. The State, in accordance with law, protects the rights of citizens to private property and to its inheritance . . ."¹²

This amendment is of great importance for China as it moves towards constitutionalism. However, what is still starkly lacking is supporting provisions in Chinese law to protect these private property rights, for example, by the courts striking down arbitrary taxation by government. But while no duty is placed directly on government to respect private property rights, a duty is

⁹ Wang Yi, a Chinese legal scholar, argues that the private property right is one of the predetermined constraints of a constitutional polity. Changing a piece of private property into state owned property is completed either by direct appropriation with violence or by tax with legal provisions. If the former is allowed, it would entirely negate constitutionalism. If the latter is accepted, it logically means that the private property right forms a limit on government powers. See Wang Yi, "Li Xian Zheng Ti Zhong De Fu Shui Wen Ti [The Taxation Problem in a Constitutional Polity]" (2004) 5 *Fa Xue Yan Jiu [Chinese Journal of Law]* 12-22.

¹⁰ See Joseph A. Schumpeter, "The Crisis of the Tax State", in Richard Swedberg (ed), *The Economics and Sociology of Capitalism* (Princeton, New Jersey: Princeton University Press, 1991), p 108.

¹¹ Adopted on 4 December 1982, and the amendments of 12 April 1988 by the 7th National People's Congress (NPC), of 29 March 1993 by the 8th NPC, of 15 March 1999 by the 9th NPC, and of 14 March 2004 by the 10th NPC have been incorporated.

¹² The Constitution of the People's Republic of China, Art 13.

imposed on people to pay taxes.¹³ This logical flaw in the Constitution may indicate a reason why ordinary citizens and businessmen are indeed reluctant to pay taxes. The rights of people as taxpayers have long been ignored or paid less attention to by politicians, legislators, and researchers as well.¹⁴

Modern tax law theory tells us that taxes, in a democratic nation or a constitutional polity, should be the major revenue source for the government to survive and maintain itself.¹⁵ The government actions of imposing and spending taxes should be done strictly in accordance with law. If a government is able to arbitrarily collect money from citizens and businesses without their consent, it may be impossible to prevent the government from inappropriately disturbing the operation of the market and infringing upon people's liberty.¹⁶

Contemporary China, unfortunately, has faced the above problems. By way of miscellaneous administrative fees, governments, especially local governments, obtain extra money readily with no regard to constraints of laws.¹⁷ In the realm where the government should not interfere with freedom of private rights, the government has done too much.¹⁸ Meanwhile, in the

¹³ *Ibid.*, Art 56: "It is the duty of citizens of the People's Republic of China to pay taxes in accordance with the law".

¹⁴ In the literature dealing with China's taxation systems and with China's move towards the "rule of law" there has been no systematic study on taxpayers' rights and the effects of taxation on constraining government powers in China since traditionally and until now, the tax law is usually regarded as one branch of economic law by many Chinese legal scholars. The constitutional meanings of taxation are overlooked. Even in the west, a specific analysis of constitutional tax limits has not been undertaken well until Geoffrey Brennan and James M. Buchanan published their book *The Power to Tax: Analytical Foundations of a Fiscal Constitution* in 1980. See Brennan and Buchanan (n 6 above), p xi.

¹⁵ Taxes are one of the ways governments raise revenues. Other ways include charging fees for specific services rendered and imposing fines or monetary penalties where certain rules are breached. Also, when government expenditure exceeds government revenue (eg from taxation) the government runs a budget deficit. The government either borrows from the public by selling bonds or prints money to the public to finance this deficit. See John Cullis and Philip Jones, *Public Finance and Public Choice* (New York: Oxford University Press, 2nd edn, 1998), p 257.

¹⁶ See Michael L. Ross, "Does Taxation Lead to Representation" (2004) 34 *BJ Pol S* 232–246.

¹⁷ As a matter of fact, there was usually no specific stipulation on the imposition and spending of administrative fees, either substantively or procedurally in China before recent reforms. It is therefore ironic that no law is provided for local governments or government agencies to obey. For example, in China's rural countryside, the "three irregulars (*sanluan*)", indiscriminate collection of fees, fundraising, and apportionment of expenses (*luan shoufei*, *luan jizi*, *luan tanpai*), were the most indeterminate and open-ended of the burdens on most Chinese peasants in the middle and late 1990s. Villagers had strong ideas about the legitimacy of particular exaction. They accepted both the inevitability and legitimacy of taxes, but they were enraged by the arbitrary, unpredictable, and open-ended nature of these tax burdens, and the coexistence of what was legal and what was illegal. No doubt, the "three irregulars" problem reflects, in part, the scarcity and absence of tax laws. See Thomas P. Bernstein and Xiaobo Lu, *Taxation without Representation in Contemporary Rural China* (Cambridge: Cambridge University Press, 2003), pp 53–78.

¹⁸ The administrative examination and approval procedure is a typical example of such interventions. Administrative agencies can employ their authority in way which interferes with the efficient operation of the market. The existence of too many administrative approvals has been an obstacle for economic development since these approvals formed unreasonable trade restrictions and heavy burdens on enterprises and traders. Although many of them have been abolished and the procedure has been regulated by the Law on Administrative Licensing of the People's Republic of China, which was promulgated by the SCNPC and took effect on July 2004, there is still a long way to go before it can be said that the government normally acts in accordance with law. See Ying Songnian, "Xing Zheng Xu Ke Fa Shi Shi Yi Lai Suo Bao Lu De Wen Ti [Problems Occurred after China's Law on Administrative Licensing Taking Effect]" (2005) 9 *Zheng Fu Fa Zhi* [Government Legal Systems] 22.

area where government is needed to positively provide public services and assistance to common citizens, the government has unsatisfactorily done little, sometimes nothing.¹⁹ The issue here seems to track the politically more familiar contrast between small government and big government.

Such a contrast has been hotly discussed by western scholars. Some argue that personal liberty can be secured only by limiting government's interference with freedom of action and association, and individual freedom requires not governmental performance but only governmental forbearance.²⁰ Others, however, maintain that no right is simply a right to be left alone by public officials; all rights are claims to an affirmative governmental response.²¹

This debate in China, however, is not about either small government or big government, but about how to make the government observe laws while developing and improving government effectiveness. To efficiently protect human rights and successfully safeguard economic development requires a true limited government in China, which is capable of liberty protection and equality promotion and is able to shield the private realm while reallocating tax dollars legally and fairly.

This is surely a picture of a rather ideal government, but how should steps be taken towards realising it? If there are no feasible methods to constrain the government's power to collect and spend money, this aim is unlikely to be reached. Since constitutional private property rights protection has been in existence in China for only about two years, and China's market economy is still at the transitional stage, it is perhaps understandable that there has been little systematic study on how to limit government by controlling its power to tax. This article therefore sets out to provide a legal understanding of basic taxpayers' rights on which the development of a limited government relies. In China, taxpayers' rights are very new and unfamiliar to common citizens, and even to the government. The lack of a tradition of believing in the "rule of law" shows that it may be important to stress the point that citizens, as taxpayers, have the right to decide what and how taxes are imposed, and to check what the government has done with its budget.

¹⁹ For example, 9-year compulsory educations, public healthcare, environmental protection, and so on, are the fields that call for the government to seriously discharge their duties to serve the public. The government, however, especially those at local levels, could not perform their responsibilities well and aroused tremendous criticism from the public. See Tai Liren, "Xing Zheng Bu Zuo Wei Zhi Te Zheng Ji Dui Ce Yan Jiu [Problems on the Illegal Administrative Non-Actions and Their Countermeasures]" available at <http://www.chinacourt.org/public/detail.php?id=157411>.

²⁰ *Roe v Wade* (1973) 410 US 113; *Maher v Roe* (1977) 432 US 464.

²¹ See Stephen Holmes and Cass R. Sunstein, *The Cost of Rights: Why Liberty Depends on Taxes* (New York: W. W. Norton & Company, Inc., 1999), p 44.

China's Taxation Problems

General

Tax, according to Black's Law Dictionary, refers to "A charge by the government on the income of an individual, corporation, or trust, as well as the value of an estate or gift. The objective in assessing the tax is to generate revenue to be used for the needs of the public."²² This definition illustrates that tax, in a modern constitutional polity,²³ has two essential characteristics. The first one is that tax is an enforced contribution exacted pursuant to legislative authority, which means no one but the legislative authority has the right to decide what kinds of tax will be imposed and how. The principle of "no taxation without representation" or "no taxation without law", adopted in the constitutional laws by many countries today,²⁴ embodies such an idea. The second characteristic is that the purpose of people paying tax is to support the government, for the administration of the law, and as the means for continuing in operation the various legitimate functions of the state.²⁵ Briefly speaking, tax is the charge people pay to the government to buy its public services.

An important distinction needs to be drawn between a "tax" and a "fee". Taxes are levied on the community as a whole, regardless of who captures the benefits of the public services funded thereby. Fees, by contrast, are charged to specific beneficiaries in proportion to the services they personally receive. The protection of individual rights, including private property rights, is generally funded by taxes, not by fees.

These basic and significant characteristics of tax, however, are not fully found in China's taxation system. Three main problems are frequently highlighted by Chinese scholars.

Direct Taxes and Indirect Taxes

Economic researchers²⁶ and some tax law scholars²⁷ have pointed out that indirect taxes, rather than direct taxes, comprise the major part of the taxation

²² *Black's Law Dictionary* (Minnesota: West Publishing Co., 6th edn, 1990), p 1457.

²³ Tax can only make sense in a constitutional polity because in a feudalistic regime, emperors or despots, on the basis of feudatory land ownership, usually drew their fiscal tributes from land rents. Such gains, in fact, were often nothing but extortion and plunder; common people had no private property rights to fight against imposition on their money or lands.

²⁴ For example, the Constitution of France (Art 34) and the Constitution of Italy (Art 23) have adopted the principle.

²⁵ *City of Newark v Jos Hollander, Inc.* 136 NJEq.539, 42 A.2d 872, 875.

²⁶ See Liu Zuo, Zhu Guangjun, Yao Xin and Zhang Xuan (Project Team of the Taxation Study Institute of China's State Administration of Taxation, SAT), "Zhi Jie Shui Yu Jian Jie Shui Guan Xi De Zai Yan Jiu [Re-study on the Relationship between Direct Tax and Indirect Tax]" (2004) 5 *Cai Zheng Yan Jiu* [Public Finance Study] 33–36.

²⁷ See Xiao Xuehui, "Taxpayers, The Right of Voting and Other Issues" (in Chinese) available at http://www.china-review.com/execute.asp?path=/content_files/xxh-011106-nsrxiq.htm20011107/xxh-011106-nsrxiq.htm&luntantitle=纳税人、选举权及其他; Wang, n 9 above.

system in China. However, modern tax law theorists, especially Kitano Hirohisa, a leading Japanese scholar, contend from a constitutional viewpoint that the constitutional principle, “popular sovereignty”, can be embodied only in direct taxes.²⁸ The reason is that under such a tax system, it becomes possible for the majority of taxpayers to be considered a party in the taxation legal relationship. They enjoy their legal rights as taxpayers while having a duty to pay.

With indirect taxes, the actual taxpayers are not the initial taxpayers provided for by tax laws. Take a typical alcohol tax for instance. Tax law provides that the person manufacturing alcohol has the duty to pay the tax, but in fact, the tax is paid by the final consumers. In this type of taxation legal relationship, final consumers, as indirect taxpayers, find it difficult to claim any right which is theirs. The relationship makes it more difficult for them to argue for government services based on tax paid. Once indirect taxes become a dominant part of the tax regime, it reduces the capacity of citizens-taxpayers to monitor and constrain government power.²⁹

Indeed, the categorisation of direct taxes and indirect taxes occupies an important position in tax law.³⁰ This categorising is based on the allocation principles of taxation which apply to most taxation arrangements.³¹ The first principle is imposing heavier taxes on the rich, ie the principle of equality of burden. The second is the principle of general imposition. Direct taxes meet the first principle and indirect taxes the second. In terms of the former, taxation with a higher progressive direct tax rate makes the rich pay much more money

²⁸ See Kitano Hirohisa, *Shui Fa Xue Yuan Lun [Basic Theory on Tax Law]* (Beijing: China's Jiancha Press, 4th edn, 2001), p 25.

²⁹ *Ibid.*, pp 406–409.

³⁰ In western developed economies, whether a state should impose direct tax or indirect tax has long been debated among political economic scholars. John S. Mill analysed this problem in his well-known book, *Principles of Political Economy with Some of Their Applications to Social Philosophy*. Based on certain comparisons, he criticised those who were not in favour of direct taxes and did not agree that the burden of indirect taxes, such as excise tax, was less than that of direct taxes. He also pointed out that both direct taxes and indirect taxes should take consideration of people's basic living conditions, either fixing a tax threshold for the direct taxation or exempting life's necessities from indirect taxing. See John S. Mill, *Principles of Political Economy with Some of Their Applications to Social Philosophy* (London: Longmans, Green, 1922), Book V, Ch VI. In today's world, usually, developed countries tend to make direct tax principal in their taxation system, but developing countries are quite the reverse. In China, the theory of direct taxes and indirect taxes did not arouse scholars' attention until the late 1970s. There are also many debates on the issue of which tax type is favourable and reasonable for China's development. Although opinions are still different, scholars and reformers generally agree the point that these two tax types are supplementary to each other. That is, the use of one does not, in principle, mean the other should be excluded. See An Tifu and Wang Haiyong, “Xin Yi Lun Shui Zhi Gai Ge: Xing Zhi, Li Lun Yu Zheng Ce [The New Tax Reform: its Nature, Theory and Policy]” (2004) 5 *Shui Wu Yan Jiu [Taxation Study]* 2–7; (2004) 6 *Shui Wu Yan Jiu [Taxation Study]* 2–6.

³¹ In tax theory, most would find Adam Smith's canons or basic principles of taxation attractive. They are: (1) equity: individuals ought to contribute “as early as possible in proportion to their respective abilities”; (2) certainty: tax liabilities should not be arbitrary or uncertain; (3) convenience: the manner and timing of tax payments should be convenient to the taxpayers; and (4) economy or efficiency: the excess burdens (or welfare costs) of taxation should be minimised. These principles continue to influence today's tax theory and tax practice, though they are also criticised by many economic scholars. For details, see Cullis and Jones (n 15 above), pp 244–246.

than the poor so that the aim of adjusting wealth distribution inequality becomes possible. On the basis of the latter principle, each citizen would pay a range of indirect taxes. This can be a supplementary revenue collection means to direct taxes, whereby citizens would feel a connection with the state and politics as well.³²

The advantages of direct taxes, typically the individual income tax properly applied, lie in three aspects. First, the imposition is in line with taxpayers' personal capacity, taking consideration of their basic living conditions and special social needs such as the cost of children's education.³³ Second, the taxable sources are relatively stable: they are mainly from incomes or properties; and the progressive tax rates are easily applied.³⁴ Last, the tax rate is flexible. As a result it can be adjusted to the needs of real situations or to abnormal circumstances.³⁵ There are disadvantages, of course. Taxpayers can feel real true pain when being taxed in this way since such taxes cannot readily be transferred to another person. Therefore, taxpayers may attempt to avoid paying heavy taxes. On the other hand, there tends to be less of a problem with tax evasion where indirect taxes are concerned,³⁶ since the burden can be moved onto others.³⁷ What is more, "tax misery" may be less because indirect taxes are not readily noticeable by payers. But indirect taxes do not satisfy the principle of equality.

These characteristics of direct and indirect taxes explain why imposing direct taxes, historically, was more likely to provoke people to revolt against

³² See Ma Yinchu, *Cai Zheng Xue Yu Zhong Guo Cai Zheng [Public Finance and China's Practice]* (Beijing: Shang Wu Yin Shu Guan, 2001), pp 217–220.

³³ In tax law theory, the direct tax is imposed on the net income of individuals. Taxable income does not include the necessary expenditures on minimum living conditions and some emergencies for individuals. This meets the constitutional requirements – the principle of fairness and basic human rights protection. See n 28 above, pp 97–104; Ge Kechang, *Shui Fa Ji Ben Wen Ti [Basic Issues on the Tax Law]* (Beijing: Peking University Press, 2004), pp 117–130.

³⁴ See Xiong Wei, "An Introduction to Relevant Knowledge" (in Chinese) available at http://www.cftl.cn/show.asp?c_id=361&a_id=621.

³⁵ For example, according to the study of Seligman, the income tax was originated from the war tax in order to meet the demands of financial deficits in the war time. Today, direct tax is a useful instrument for governments in regulating macro-economies and realising social welfare policies by adjusting tax rates or changing tax bases. See An Furen, *Zheng Fu Zhi Neng Yu Shui Shou Wen Ti Yan Jiu [Study on Government Functions and Taxation Problems]* (Da Lian: Dongbei University of Finance and Economics Press, 2002), pp 137–143.

³⁶ Mill clearly pointed out, "A direct tax is one which is demanded from the very persons who, it is intended or desired, should pay it. Indirect taxes are those which are demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another: such as the excise or customs." He exemplified the argument that the producer or importer of a commodity is required to pay a tax on it, not intentionally imposing him a tax, but through him to tax the consumers of the commodity. He would recover the amount by virtue of enhancing the sell price of the commodity. In this sense, the nominal taxpayer does not need to evade tax payments. See Mill (n 30 above), Book V, Chapter III.

³⁷ But there still exist some exceptions in the current taxation system of China, such as the Value-Added Tax (VAT). To make out a voucher of VAT unrelated to a real transaction, or to forge a VAT voucher, or to sell VAT vouchers illegally are very common phenomena in China. The SCNPC, the Supreme People's Court (SPC) and the SAT have all noted these illegal actions and have made decisions, interpretations or circulars respectively to control the uses of VAT. See *China Law Database* (in Chinese) available at <http://147.8.31.41:168/web/index2.html>.

the authorities. Take the War of Independence in America for instance. Taxation had been in existence before the war, but nearly all such taxes were indirect taxes. The American colonies did not feel much incentive to resist. They accepted taxes as one of the costs of doing business. The power of Parliament to tax colonial commodities for the regulation of trade had long been accepted in theory, though not always in practice. But as stated in the Revenue Act of 1764, the power to tax “for improving the revenue of this Kingdom” aroused tremendous debates in the colonies. Samuel Adams, a colonial lawyer, found in the preamble the first intimation of “taxation without representation”, which drew many people to the cause of the American patriots fighting against the United Kingdom. In 1765, the notorious “Stamp Act” was easily passed by the Parliament in London, but unexpectedly sparked violent resistance in the thirteen colonies since it taxed equally all parts of the country.³⁸

The colonial people had a feeling of their private property being “robbed” through taxation. Spurred by Patrick Henry, the Virginia Assembly passed a set of resolutions denouncing “taxation without representation” as a threat to colonial liberties. Further, the 1765 Congress asserted that “no taxes ever have been or can be constitutionally imposed on them, but by their respective legislatures”. The King and the Parliament, however, denied them any right to send representatives to the Parliament in London, which was an essential constitutional right of many taxpayers in Great Britain. Although finally the British Parliament yielded and repealed the Stamp Act under the pressure of British merchants and a repeal movement, the Townshend Duties of 1767 provoked violence once again. In 1770, the Boston Massacre³⁹ forced the Parliament to nullify all the Townshend duties except that on tea. The tea tax was retained because, as George III said, there must always be one tax to

³⁸ The Stamp Act provided that revenue stamps be affixed to all newspapers, broadsides, pamphlets, licenses, leases, or other legal documents, the revenue (collected by American agents) to be used for “defending, protecting, and securing” the colonies. The act, however, aroused the hostility of the most powerful and articulate groups in the population, journalists, lawyers, clergymen, merchants, and businessmen, north and south, east and west, for it bore equally on all sections of the country. Soon leading merchants, whose every bill of lading would be taxed, organised for resistance and formed non-importation associations. This tax burden was so evenly distributed in the 13 colonies that it increased costs of commercial acts and ordinary living for many people. In this sense, the tax bore some characteristics of direct tax.

³⁹ The Boston Massacre broke out on 5 March 1770. This was an eruption after 18 months of resentment of colonial citizens. The agitation following enactment of the Townshend Duties was less violent than that stirred by the Stamp Act, but it was nevertheless strong. In Boston where the mercantile interests were most sensitive to any interference, enforcement of the new duties provoked violence. When customs official sought to collect duties, they were set upon by the populace and roughly handled. For this, two regiments were dispatched to protect the customs commissioners. The presence of British troops in Boston was a standing invitation to disorder. On 5 March 1770, antagonism between citizens and British soldiery flared up. A harmless snowballing in the beginning degenerated into a mob attack. Someone gave the order to fire; three Bostonians lay dead in the snow; and colonial agitators had a valuable issue to arouse hostility toward England. The incident was dramatically pictured as proof of British heartlessness and tyranny. See “Captain Thomas Preston’s Account of the Boston Massacre (13 March 1770)” available at <http://www.let.rug.nl/~usa/D/1751-1775/bostonmassacre/prest.htm>.

keep up the right. Although this tax in nature was like an indirect tax, it embodied the King's power to tax. A small number of "patriots" or "radicals" in the colonies contended that so long as the tea tax remained, the principle of Parliament's right over the colonies remained. Thus, the tea tax served as a fuse, ultimately leading the colonies to the independence war.⁴⁰

In history, it is evident that direct taxes played an indispensable role in establishing modern constitutionalism and shaping ideas of limited government.⁴¹ In this sense, modern developed countries usually adopt a taxation system which places direct taxes in a central position. For instance, the percentage of direct taxes in the total revenues of the United States in 2003 was 82 per cent.⁴² In the European Union countries in 1997 the average percentage of direct taxes was 68 per cent and that percentage has remained until now.⁴³ In China, in a sharp contrast, indirect taxes accounted for 76.4 per cent of total revenue in 2004.⁴⁴ This not only conceals the fact of tax payment, but also leads to the result that citizens are less well placed to be able to check the operation of government.⁴⁵ Such a situation does not allow taxpayers clearly and readily to know how much the government has taxed them. They remain ignorant of the true tax burden being imposed on them.

Income Taxes

The second problem is that where you have an unfair income tax system, especially where the income tax system does not work well in its social adjusting function, it can aggravate the wealth gap between rich and poor, and also damage the balance between individual incomes and government revenues.

There is a series of data to illustrate the problem. The Gini Coefficient⁴⁶ has increased in China from 0.33 in the beginning of 1980s to 0.388 in 1995

⁴⁰ See "Taxation without Representation at Issue" in *An Outline of American History (1990)* Ch 2, available at http://www.let.rug.nl/usa/H/1990/ch2_p6.htm; also see Zhou Gangzhi, *Lun Gong Gong Cai Zheng Yu Xian Zheng Guo Jia* [On Public Finance and Constitutional States] (Beijing: Beijing University Press, 2005), pp 66–71.

⁴¹ This point is especially true in the history of western European countries. See Schumpeter (n 10 above), pp 100–108.

⁴² Statistics come from OECD. 2005, *Revenue Statistics 1955–2003* (OECD, Paris).

⁴³ Statistics come from European Communities, *Tax Policy in the European Union 2000*.

⁴⁴ See the SAT, "Statistics of Tax Revenues" available at <http://www.chinatax.gov.cn/data.jsp>.

⁴⁵ See n 28 above, pp 25–27.

⁴⁶ The Gini Coefficient is a measure of inequality of a distribution, defined as the ratio of area between the Lorenz Curve of the distribution and the curve of the uniform distribution, to the area under the uniform distribution. It is often used to measure income inequality, and it can also be used to measure wealth inequality, but requires that no one has a negative net wealth. It is a number between 0 and 1, where 0 corresponds to perfect equality, for example, each person has the same income, where 1 corresponds to perfect inequality, for example, one person has all the income, and everyone else has zero income. Poor countries with low per-capita GDP have a Gini Coefficient range from low (0.25) to high (0.71), while rich countries have a generally low Gini Coefficient (under 0.40). This measure has obvious advantages on the one hand. On the other hand, it also contains limitations to actually describe a country's economic situation. For its detailed explanation see WIKIPEDIA available at http://en.wikipedia.org/wiki/Gini_coefficient.

to 0.458 in 2003 and to nearly 0.5 in 2004.⁴⁷ These figures indicate a continual rise in income inequality in China. According to international standards, when the Gini Coefficient reaches 0.4 or above, the extent of income distribution in a country will become unequal. Data from China's State Administration of Taxation (SAT) shows that the individual income tax has been the tax type rising the fastest since 1994, and it has become the fourth highest tax type in China's taxation system.⁴⁸ The progressive income tax rate is mainly applied to wages and salaries,⁴⁹ and the tax threshold for them is too low.⁵⁰ The principal income sources of the high-income group are not from wages and salaries but other profits. This increase means that the average working person is paying a significant part of this increase in income tax. For example, taxes from salaries and wages account for 54 per cent of income tax revenues in 2004, and the percentage of taxes on wages and salaries in the total income tax revenues of Shanghai, Beijing, Shenzhen, Xiamen and cities like these is more than 65 per cent.⁵¹ Xie Xuren, the Commissioner of the SAT indicated that the national individual income taxes in 2004 were RMB 173.705 billion. Some 65 per cent of this amount was drawn from the working class, but not the high-income group.⁵² What is more, the high-income group is able to use many methods to evade tax⁵³ since the actual incomes are hard to assess and difficult to supervise. This exacerbates the seriousness of the income gap between rich and poor.

⁴⁷ World Bank, *World Development Reports 1980–2004*.

⁴⁸ The average rising speed of the individual income tax is as high as 48%. See n 44 above.

⁴⁹ See the Law of People's Republic of China on Individual Income Tax (LIIT) (revised in 2005), Sch 1 "Individual Income Tax Rates (applicable to income from wages and salaries)".

⁵⁰ The LIIT was revised for the third time on 27 October 2005. The threshold of individual income tax has long been RMB 800 per month, since its first establishment, with no regard to the increase in wages and salaries and the increase of inflation rates annually. After 1 January 2006, the threshold changed to RMB 1,600 per month.

⁵¹ See Wu Weixue, "Ge Shui Gai Ge: He Xie Mu Biao Xia De Shuang Chong Qi Dai [Reforms in Individual Income Tax: Double Expectations under the Aim of Social Harmony]" available at <http://guancha.gmw.cn/show.aspx?id=3832>; and the "Press Conference on the Reform in the Law on Individual Income Tax 2005" (in Chinese) available at <http://www.chinatax.gov.cn/view.jsp?code=20051116100128356>.

⁵² Actually, there is no clear definition of the so-called "working class" or the "high-income group". But according to the officials of the SAT, the "working class" of China refers to those people who live off their wages and salaries, not other profits or capital gains. It mainly comprises the workers in cities and townships. The structure of high-income groups is a little bit different every year depending on the changing economic development situations in China. In 1996, for instance, the areas of financial, real estate, advertising, construction, and foreign enterprise contracting projects were the central tax supervision fields over high-income groups. In 2003, the tax supervision emphasised these areas: financial, insurance, securities, electrical power, telecommunication, tobacco, high-new-technology enterprises, football clubs, and large self-employed industrial and commercial households from production or business operation. See the "Press Conference" (n 51 above).

⁵³ Tax evasion means illegally paying less in taxes than the law requires; committing fraud in filing or paying taxes. An example includes reporting less income than actually received or deducting fictitious expenses. Such acts are crimes and may result in an underpayment penalty. Tax evasion is different from tax avoidance, which refers to the minimization of one's tax liability by taking advantage of legally available tax planning opportunities. See n 22 above, pp 1461, 1460.

Such a situation where the poor pay more tax, as a percentage of income, than the rich, while the rich equally enjoy the government services, has aroused widespread criticism throughout the country.

Further, through taxation, Chinese government tax revenues are increasing dramatically by a rate two times faster than the rate of GDP increase. In 2004, the tax revenues accounted for 16.1 per cent of the GDP; and in 2005, it reached RMB 3086.6 billion.⁵⁴ The central and local governments thus have a huge amount of money to spend,⁵⁵ but the majority of the money is used for various kinds of investment. Only a minor part is spent on improving the social distribution inequality. Meanwhile, the consumption expenditure of common citizens has decreased from 65 per cent of the GDP in the 1980s to 60 per cent in the 1990s, and to 55.5 per cent by 2003.⁵⁶ The rise in the government revenues and drop in citizens' disposable incomes has resulted in an imbalance between the government and its citizens, which could prove to be harmful to the healthy development of the country's macro-economy.

Theoretically, income taxes are the best tax type to "tax the rich and help the poor", but problems which have occurred in China's income tax system demonstrate that such taxation has not functioned well to meet its goal in adjusting and improving economic and social development.

A legal scholar, Ge Kechang, has argued that individual income taxes are, on the basis of private property, closely linked with constitutional, basic human rights.⁵⁷ Different income sources involve different types of human rights.

As early as the 18th century, Adam Smith pointed out in his book, *An Inquiry into the Nature and Cause of the Wealth of Nations*,⁵⁸ that people's incomes come from three sources: rent, profit and wages. Since the rent from lands and the profits from capital are similar in nature, the sources can be mainly categorised into two kinds: income from labour, and capital gains. Constitutionally, the former is connected with the right to work

⁵⁴ Statistics come from the SAT and the Ministry of Finance of the People's Republic of China 1998–2003. This increase rate is calculated on the basis of the total tax revenues of Chinese central and local governments. The average increase rate of government tax revenues from 1998 to 2003 was 19.3%, and in the same period, the increase rate of GDP was around 8–9%.

⁵⁵ See Liu Huang, "Zheng Fu Shui Shou Gao Su Zeng Zhang Tong Shi Que Pao Qi Ying Jin Ze Ren [The Government Abandon Its Responsibilities when Its Tax Revenues Rise Steadily]" available at <http://finance.sina.com.cn>.

⁵⁶ See Zhang Shuguang, "Tuo Zhan Nei Xu Ti Sheng Xiao Fei [Expanding Domestic Consumption and Expenditure]" in *China Economic Observer October 2005* (in Chinese) available at <http://www.ccer.edu.cn/download/5783-1.pdf>.

⁵⁷ Ge Kechang, *Suo de Shui Yu Xian Fa [The Income Tax and the Constitutional Law]* (Beijing: Peking University Press, 2004), pp 3–73.

⁵⁸ Adam Smith: *An Inquiry into the Nature and Causes of the Wealth of Nations* (London: Printed for A Strahan and T. Cadell, 7th edn, 1793).

including freedom of choice of profession and professional practice; the latter is linked with private property rights including the uses of and proceeds from property.⁵⁹

People's rights of existence and human dignity in any modern country depend to a significant extent on the operation of the income tax system. Only if the income tax system takes account of the minimal living standards for ordinary citizens can it achieve real legitimacy and fairness. Generally, there are many ways in which the tax laws of western developed countries have reduced the tax burden imposed on certain poorer citizens or given them benefits, such as exemption from tax on the cost of children's education and health care. Unfortunately, there are no corresponding benefits for Chinese citizens.

As to the enterprise income taxes (business or profit taxes), they obviously connect with the autonomy of the market economy and the freedom of doing business.⁶⁰ The government power, by virtue of taxation, can strongly influence the behaviour of business. If taxation is unequal and unreasonable, it could cause discrimination against some parts of the private sector while benefiting others, disturbing the market's operational order. The different taxation arrangements for foreign enterprises and domestic enterprises provide a typical example of this problem in today's China.⁶¹

From the above statistics and analysis, we can see that reform of the income tax system in China is badly needed. Reforms are needed to improve social equality and also the balance between citizens, market and the government. Reforms of China's budget law and the accounting systems for government revenues and expenditures in accordance with the Constitution, and reforming the Law on Individual Income Tax may be particularly good steps to foster establishing a limited government and to help citizens really enjoy their constitutional rights. Moreover, they are steps which can be taken without need to change the one party state structure.

⁵⁹ See n 57 above, pp 52–53.

⁶⁰ The Constitution of People's Republic of China provides, "The state protects the lawful rights and interests of the non-public sectors of the economy, including individual and private sectors of the economy. The state encourages, supports and guides the development of the non-public sectors of the economy, and exercises supervision and control over the non-public sectors according to law." (Art 11).

⁶¹ These two separate taxation arrangements aroused criticism from the business circle and academic field as well. The SAT has planned to unify the two taxation systems in 2006. See Xie Xuren, "The Talk of Six Main Tasks of Taxation in 2006" (in Chinese), in *the National Taxation Working Meeting held on 8 January 2006* available at <http://www.chinatax.gov.cn/view.jsp?code=20060108105456249>.

Administrative Fees

A large number of administrative fees exist in China outside of the law and beyond budget control.⁶² These fees are usually collected by government agencies or local governments. Their impositions do not go through a strict law-making procedure. According to a study conducted by Yang Bin,⁶³ the total administrative fees collected in China increased from RMB 117.62 billion in 1987 to RMB 979.85 billion in 1996. The increase rate in 1996 was 20.78 and nearly 58.64 per cent of government revenue depended on these fees.⁶⁴ One major problem for fee-payers⁶⁵ is that they have no rights to speak in the National People's Congress (NPC) or relevant Local People's Congresses (LPCs). These are meant to be the people's representative congress and they function as legislative institutions.⁶⁶

⁶² See Jiao Jianguo, "Chong Jian Yu Suan Zhi Du: Jian Li Gong Gong Cai Zheng De Gen Ben Tu Jing [Reconstruct the Budget System: A Basic Way to Public Finance]" (2000) 5 *She Hui Ke Xue Ji Kan* ([*Social Science Quarterly*] 68–72; Gao Peiyong and Ma Caichen, "Zhong Guo Zheng Fu Yu Suan De Fa Zhi Hua Jin Cheng: Cheng Jiu, Wen Ti Yu Zheng Ce Xuan Ze [Legalization Process of China's Government Budget: Achievements, Problems and Policy Choices]" (2004) 10 *Cai Zheng Yan Jiu* [*Public Finance Study*] 11–14.

⁶³ Yang Bin, "Hong Guan Shui Shou Fu Dan Zong Shui Ping De Xian Zhuang Fen Xi Ji Ce Lue Xuan Ze [Analysis of the Macro-level of Tax Burdens and Strategy Choosing]" (1998) 8 *Jing Ji Yan Jiu* [*Economics Study*] 47–54.

⁶⁴ Ruan Yisheng, "Lue Lun Gong Gong Cai Zheng Ji Qi Kuang Jia De Gou Jian [On Public Finance and The Formation of Its Structures]" in Gao Peiyong (ed), *Gong Gong Cai Zheng: Jing Ji Xue Jie Ru Shi Shuo* [*Public Finance: What Economics Says*] (Beijing: Economic Science Press, 2000), p 394.

⁶⁵ In a broad sense, this kind of fees is not a debt but a tax. See n 22 above.

⁶⁶ The NPC is defined in China's 1982 Constitution as "the highest organ of state power" (Art 57). In addition, the Constitution states that "all power in the People's Republic of China belongs to the people" (Art 2). In principle, "[t]he NPC is the supreme source of law in China and the basic laws and other laws adopted by the full NPC or its Standing Committee are the highest form of law after the Constitution." In reality, the NPC traditionally has been subservient to the leadership's wishes. Beginning in the early 1990s, this role has gradually changed, and the NPC has begun to exercise more control over the legislative and policy agenda in accordance with its constitutional mandate. This change follows leadership efforts to define more clearly the scope of the NPC's legislative powers, to unify the legislative system to prevent conflicts of laws, and to improve the overall quality of legislation. Around 3,000 members of the NPC meet once a year and serve 5-year terms. Delegates are elected by the people's congresses at the provincial level, by autonomous regions, and by the People's Liberation Army as well. Provincial delegations meet before each NPC session to discuss agenda items. Because of the infrequent meetings, the NPC functions through a permanent body, the SCNPC, whose members it elects. The SCNPC's powers were enhanced in 1987 when it was given the ability to "enact and amend laws with the exception of those which should be enacted by the NPC", thus giving this body legislative powers. The SCNPC presides over sessions of the NPC and determines the agenda, the routing of legislation, and nominations for offices. Leaders of the SCNPC are invariably influential members of the Communist Party of China (CPC) and leaders of major mass organisations. The state institutions below the national level are the local people's congresses – the NPC's local counterparts – whose functions and powers were exercised by their standing committees at and above the country level when the congresses were not in session. The people's congresses also had permanent committees that became involved in governmental policy affecting their areas and their standing committees, and the people's congresses held meetings every other month to supervise provincial-level government activities. The people's congresses at the provincial, city, and county levels each elected the heads of their respective government organisations. They also had the right to recall these officials and to demand explanations for official actions. Congresses at each level examined and approved budgets and the plans for the economic and social development of their respective administrative areas. They also maintained public order, protected public property, and safeguarded

Since such a tremendous amount of money is not effectively controlled by laws and monitored by annual budgets, it inevitably creates opportunities and incentives for government officials to arbitrarily collect money, leading to China's notorious reputation for fiscal corruption. These fees, actually types of taxes, severely violate the principle of "no taxation without law".

Moreover, government budgets are fragmented and vague.⁶⁷ The budget covers only a part of government revenues – taxes but not administrative fees. Budgets are also too abstract and opaque to let ordinary citizens know how the government collects and spends money. Governments at many levels and central ministries prefer to collect money by means of administrative fees.⁶⁸ Due to the lack of effective control, it is easy for them to withdraw money for entertainment or to provide welfare for government members with no accountability.

An unpleasant example can be seen in an announcement by the National Audit Office of the People's Republic of China on 28 September 2005.⁶⁹ The announcement was about 32 central government ministries in the 2004 fiscal year. The findings are public. The announcement says that the subordinate

the rights of citizens of all nationalities. All deputies were to maintain close and responsive contacts with their various constituents. Like the NPC at the national level, LPCs also have risen in prominence and importance in recent years. The Chinese Constitution charges local congresses and governments with legislating on specific matters relating to the localities and drafting local regulations to implement certain NPC laws. In the past decade, LPCs have been the focal point for much of the experimentation occurring in China in reforming legislative processes. This trend is due in part to increasing popular demand. The Chinese public no longer places complete trust in government officials or institutions, and increasingly looks to the law as a tool to limit government powers. As a result, the public has shown a growing interest both in seeing quality legislation produced and in having a role in the legislative process. Many LPCs now view public participation and transparency as vehicles to gain legitimacy for their legislation. The CPC, however, still exercises control over the lawmaking process at every level. Representatives in the NPC and the LPCs have limited accountability, as direct elections only take place at the very low levels. Even at these levels, some have questioned the value of elections. But some observers argue that the elections familiarise the Chinese people with the tools of democracy and could lead to a yearning for greater popular representation at highest levels of government. See "China's State Organizational Structure" available at <http://www.cecc.gov/pages/virtualAcad/gov/statestruct.php?PHPSESSID=774937e319e779fbb5e8aef49eed783>.

⁶⁷ See Gao and Ma (n 62 above).

⁶⁸ The Chinese state has been characterised by Lieberthal as one of "fragmented authoritarianism". See Kenneth Lieberthal, *Governing China: From Revolution through Reform* (New York: W.W. Norton, 1995), p 169. At the centre, a small number of generalist leaders of the CPC's Politburo are in charge of making overall policy. The national-level functional ministries over which they preside function as principals with respect to their subordinate counterparts at lower administrative levels. With regard to burdens, the country and township governments are not by any means solely responsible for the irregular fees, fines, and assessments (*sarhuan*), many centre ministries such as Public Security, Education and Public Health, authorise their subordinates to impose a wide variety of fees for delivery of the services for which they are responsible. The central generalist leadership has had great difficulty bringing these practices under control. Local governments are often not responsive to the demands of the top leaders to take care of people's rights. They often respond to development pressure and incentives as well as their personal interests. Due to the difficulty calculating exact tax revenues and fees, the sequential inadequate budgets at the central and especially at the local level further provide chances for government to arbitrarily collect miscellaneous fees. See n 17 above, pp 12, 105–109.

⁶⁹ The details of the announcement (No 11) (in Chinese) are available at http://www.audit.gov.cn/cysite/docpage/c516/200509/0928_516_14507.htm.

units of the Ministry of Education of China indiscriminately collected RMB 154 million in fees, the Ministry of Foreign Affairs of China spent RMB 18.803 million in a non-budget construction project, and the Department of National Material Reserve diverted reserve funds of about RMB 76 million to buy securities, to name just a few. Without doubt, the money was in main drawn from taxpayers or feepayers. But the payments did not go where the taxpayers and feepayers desired them to go.

It is surely not possible to avoid corruption and waste unless the budget is open and clear to the public and lists detailed items of expenditures. If administrative fees continue to grow, it is very unlikely China will be able to protect people's private property rights, as guaranteed by the Constitution.

The principal victims of administrative fees, Chinese farmers,⁷⁰ have seen their living conditions worsen.⁷¹ Heavy tax burdens placed on them have caused a series of social problems, such as poor students dropping out of school. A study shows that fees imposed on farmers are 3.2 times the average agriculture tax rate (8.8 per cent).⁷² Before recent reforms in individual income tax law and agriculture taxes,⁷³ compared with urban residents who are free of taxes if their personal monthly income is lower than RMB 800, every farmer had to pay a poll tax no matter how much he or she earned. This unfair treatment totally violated the Constitution's stipulation, that "All nationalities in the People's Republic of China are equal" (Article 4) and "The state respects and preserves human rights" (Article 33).⁷⁴

⁷⁰ It is not safe to say that *all* Chinese farmers are poor and suffer heavy tax burdens. According to a study, if China's provinces are divided into three categories based on their level of economic development, a clear pattern emerges: those in the mid-level development areas defined in terms of income bore the heaviest burden. Rural incomes were high in the costal belt of provinces, medium in the central provinces, lowest in the western ones because poverty was so severe, whereas the relative tax load was lowest in the richer East and highest in the central region where most grain-producing provinces are located. See n 17 above, p 62.

⁷¹ See Xiao Xuehui, "Taxpayers: Speak Out Your Rights" (in Chinese) available at http://www.china-review.com/execute.asp?path=/content_files/xxh-011106-nsr.htm20011107/xxh-011106-nsr.htm&luntantitle=纳税人, 说出你的权利; Zhao Deyu, Gu Haiying, Shi Qinghua, "Zhong Guo Nong Cun De Shui Fei Zhi Du Gai Ge [Reforms in Systems of Taxation and Administrative Fees in China's Countryside]" (2004) 6 *She Hui Ke Xue [Social Science]* 22-28.

⁷² See Zhao, Gu and Shi (n 71 above).

⁷³ The CPC and the Central Government of China have made a series of policies and regulations to alleviate farmers' heavy burdens since 2000. In 2004, the agricultural taxes were gradually reduced or remitted in some regions on trial. In 2005 the agricultural taxes were fully remitted in 28 provinces including cities and districts. At the end of 2005 the SCNPC made a decision that the Regulation on the Agricultural Taxes would be abolished from 1 January 2006. With this decision, in comparison with burdens of paying taxes and fees before 2006, farmers' burdens will be reduced by RMB 125 billion. See the "Talk of Xie Xuren in a Discussion Meeting for Commemorating Abolishment of the Regulation on the Agricultural Taxes and Fully Revoking Agricultural Taxes in 23 February 2006" (in Chinese) available at <http://www.chinatax.gov.cn/view.jsp?code=200602231055439089>.

⁷⁴ Although China's agriculture taxes were repealed on 1 January 2006, it does not follow that the burden problem of Chinese farmers has been completely solved. Basic education, healthcare services, social security, environmental protection, and other kinds of fundamental issues need revenue sources to deal with. Even in 2004, with reduction in the agriculture tax in many provinces, rural income per capita increased by 6.8%, but still lagged behind the urban growth rate of 7.7%. The adverse impacts

Modern tax law theory believes that the poll tax is notably out-dated tax which does not meet the requirements of human rights protection. Many countries have abolished it. As for special agriculture taxes, developed countries have not only abolished them but also pay an allowance to farmers.⁷⁵ In comparison, Chinese farmers live harshly – the taxes they pay to the government are not commensurate with the government services they are entitled to. Fortunately, the tenth NPC held in 2005 decided to revoke agriculture taxes. However, there has no been further discussion or studies on the other kinds of fees imposed by government agencies or local governments. Nor have these been studies on discussion about the rights that farmers should enjoy as taxpayers.

Perhaps, the most important reason why citizens are unwilling to pay taxes lies in their near complete lack of ability to participate in government and official decision making. They usually lack access to relevant LPCs or the NPC. They are unable to demand government services. They cannot sue when regulations and rules concerning their basic human rights are unconstitutional.

Researchers such as Sun have explained these problems from a cultural or historical perspective.⁷⁶ Sun argues that people in China have traditionally seen the government as their ruler and that China has exercised a socialist economic system for a long time,⁷⁷ yet this is not sufficient to explain China's tax problems. Tax, especially income tax, directly connects with citizens' private property rights, and tax policy is a key part of the "rule of law" and limited government. The issues raised above from the point of view of modern constitutional theory will now be considered.

Influence of Modern Constitutional Theory

It is generally acknowledged that constitutionalism refers to two basic maxims. One is the "rule of law", which simply means that the law should be respected

of China's 1994 tax reform and the fee-to-tax conversion that went nationwide in 2002 still remained on social and economic developments in China's countryside. Loss of revenue from the agriculture tax will cut deeply into village and township budgets. This problem is to be managed through a combination of compensation from higher levels and a shifting of responsibility for public services upward to the countries. There is also room for streamlining administration and cutting expenses to ameliorate the strain, particularly through consolidation of administrative jurisdictions and reduction of excessive employment. Without further reforms and improvements in countryside, inequality between urban citizens and countryside farmers is likely to remain in China. See Lu Mai and Calla Wiemer, "An End to China's Agriculture Tax" (2005) 3 *China: An International Journal* 320–330.

⁷⁵ See Zhao, Gu and Shi (n 71 above).

⁷⁶ Sun Fei, "Zhong Guo Shui Shou Liu Shi: Ren Xing Gen Yuan Fen Xi [China's Tax Loses: An Analysis on the Human Being's Nature]" (2004) 2 *Cai Zheng Yan Jiu [Public Finance Study]* 21–22.

⁷⁷ *Ibid.*

everywhere, and no one including the government can take actions beyond the law. The other is the idea of “limited government”, which means the government must be controlled by a system of laws and be responsible, in accordance with laws, for its illegal or unconstitutional actions. To some extent, the latter makes for a solid foundation for the former; if the government is unlimited, the “rule of law” is likely to be severely damaged.

Western constitutional theory developed further as the market economy system matured. Classical economic theory, mainly established by Adam Smith, suggests that the government should lift its hands from the market and its power should be constrained in order to secure the market mechanism and to protect people’s liberty.⁷⁸ But later developments in market theory showed that some dysfunctions in the market could not be remedied by the market itself.⁷⁹ It became necessary for the government to employ its power to mend this disorder. This kind of economic theory has prevailed in western advanced economies since the period of Great Depression, which gave rise to the growth in size and scope of the administrative bureaucracy, along with the increasing concentration of authority in the central or federal government in the USA.⁸⁰

Such a development in economics profoundly changed constitutional theory. The necessity of maintaining a healthy market made governments become stronger and stronger. However, it is now believed that the more energetic the government, the more necessary its power should be constrained. But the issue is how to control the government: numbers of researchers indicate that specifying clear rules about taxation, among other things, is an effective way to curb excessive government power.⁸¹

Under a constitutional polity, the government should, it is argued, derive its revenues largely from taxes, which are impositions on citizens’ private property. Only if the government gets the agreement of the people, usually through the Congress or the Parliament, can the government impose taxes. It is people who decide what kind of taxes can be imposed and how. After that, the government must be seriously responsible for the way it spends taxes. Through an open and transparent procedure to control imposing and spending taxes, there should be fair fewer chances for government to abuse its power. If a government is short of funds, it cannot take action at its whim. In addition, where the government fails to provide services commensurate with taxes, people will be more likely to urge the government perform its duties legally and fairly or otherwise cut tax burdens, or they will try to throw the government

⁷⁸ See n 58 above.

⁷⁹ See John M. Keynes, *The General Theory of Employment, Interest and Money* (London: Macmillan, 1936).

⁸⁰ See James M. Buchanan, *Constitutional Economics* (Oxford, UK: Blackwell, 1991), pp 7–9.

⁸¹ See Brennan and Buchanan (n 6 above); Hirohisa (n 28 above).

out at the next election. By the means of taxes, hence, the government is, at least in theory, constrained within a necessary sphere to help maintain the market order while insuring private property rights protection.

In this sense, a few insightful scholars hold that taxes are vital to constitutionalism.⁸² They point out taxes concern not only taxpayers' private property rights but, more importantly, connect with their civil and political rights. These latter rights limit government power and lead to the "rule of law".

This finding has made a notable contribution to the clarification of "limited government" and continues to be relevant to studies on taxpayers' rights. A new school of thought in constitutional theory called "constitutional economics" has been developed by Buchanan. It has had a wide influence within and outside western countries. In Japan, Kitano Hirohisa has proposed a new type of human rights – taxpayer's fundamental rights. He says these new rights rest on the basis of the constitutional law, including the public finance law in a broad sense. Taxpayers have the right to process a "taxpayer's suit" if they think the tax system is unfair or taxation actions are illegal or the government's expenditures that may increase their tax burdens violate the constitutional law.⁸³ Such a view coincides with Buchanan's views.

These studies show that realising constitutionalism cannot be separated from taxes, or more specifically, cannot be independent of taxpayers' rights. Such a legal understanding, to some extent, impels China's scholars to study China's own problems. However, these findings have nearly all been derived from developed countries with the economic background of a mature market. They appear to be narrow in application and it is unlikely that they demonstrate what can be used in a developing country like China to achieve a limited government by way of taxation-based reform.

Admittedly, in China, common citizens hardly have a sense of being taxpayers, though they directly or indirectly pay much tax to the government. One reason suggested by Sun is the influence of traditional philosophy.⁸⁴ Confucianism places the government in a superior position to the populace and emphasises that citizens should always obey government orders. However, this view may well be fading in its effect. Today, more and more citizens have acquired real private property rights and they wish to prevent the government from interfering with them.

The other reason that citizens have little sense of being taxpayers is China's current economic position. China is at a transitional economic stage. Before the "Open-door Policy" commenced in the late 1970s, China adopted a

⁸² See Liu Junning, Gong He, Min Zhu, Xian Zheng: *Zi You Zhu Yi Si Xiang Yan Jiu [Republic, Democracy, and Constitutionalism: Study on Liberalism]* (Shanghai: Shanghai San Lian Shu Dian, 1998); Hirohisa (n 28 above).

⁸³ See n 28 above, pp 300–312.

⁸⁴ See n 76 above.

socialistic planned economy. In line with such an economic system it had an unlimited government, which actively managed everything for the country and its citizens. People's income levels were very low because the other parts of their contributions⁸⁵ had been deducted by the government before giving them salaries. Things have changed. The adoption of a market economy has forced the government to meet many new challenges. Otherwise, the (older) system of government would be a huge obstacle in the way of fostering the country's economic and social development. The most important step, so far, in this regard is to admit and safeguard private property rights in the Constitution.

However, such written rights are not enough to transform an unlimited government into a limited one. It is doubtful whether the government has enough incentive or good faith to change itself without proper forces applying checks and controls.⁸⁶ Arthur Seldon, a famous economist, argues that

“[independent] Government is no longer to be seen as the impartial referee who sets the by-laws by which the economic ‘game’ in the market is played, but a powerful participant in the game, much more powerful than the individuals or firms and other ‘players’, and liable to ignore or bend the by-laws to its advantage, always claiming that it did so in the general interest of the other players. The notation of government as the impartial chairman or referee is a myth of conventional political science that has proliferated the *etatism* that infected all British political parties.”⁸⁷

Buchanan and Gordon Tullock take a similar view to Arthur Seldon.⁸⁸

⁸⁵ Within the Chinese legal system, the individual income tax did not exist until 1980, when, for the first time, the 5th NPC passed the individual income tax law and provided that the tax threshold was RMB 800. In the quarter century of Maoist rule, much of the payment by workers in cities' industries did not come in the form of taxes as such but in the form of the state-owned enterprises' profits; and in the countryside, much of the largest burden placed on the peasantry did not come in the form of taxes also, but in the form of the compulsory procurement programme.

⁸⁶ Montesquieu, a famous philosopher, said in his well-acknowledged book *The Spirit of Laws* that absolute power corrupts absolutely. See Montesquieu, *The Spirit of Laws* (in Chinese) (Beijing: Shang Wu Yin Shu Guan, 1963), p 154.

⁸⁷ Arthur Seldon, “Introduction” in Buchanan (n 80 above), p x.

⁸⁸ Buchanan maintains in his public choice theory that there will be no return to the romantic delusion that the national government offers cures for all problems: real, imagined, evolved, or invented. There is a widespread public scepticism about government's capacities, and also about the purity of the motivations of political agents. Public choice theory, in its simplest terms, does little more than to extend the behavioural model used by economists to choices made by persons in political roles (as voters, politicians, bureaucrats). Tullock in his *The Politics of Bureaucracy* challenged dominant orthodoxy of modern political science and public administration, exemplified in the works of Max Weber and Woodrow Wilson, by asking the simple question: what are the rewards and penalties facing a bureaucrat located in a hierarchy and what sorts of behaviour would describe his efforts to maximise his own utility? In his view, bureaucrats could no longer be conceived as “economic eunuchs” It became obligatory for analysts to look at bureaucratic structure and at individual behaviour within that structure. See James M. Buchanan, *Liberty, Market and State: Political Economy in the 1980s* (Brighton: Wheatsheaf, 1986), pp 19–27; Gordon Tullock, *The Politics of Bureaucracy* (Washington, DC: Public Affairs Press, 1965).

From modern constitutional theory and tax law theory, we find that the logic of constitutional restrictions is premised on the implicit prediction that any power assigned to government may be, over some periods and under some circumstances, exercised in ways that are at odds with the desires of ordinary citizens.⁸⁹ Constitutionalism entails limited government. By fiscal constraints, especially the constraints on the government's power to tax,⁹⁰ government might be limited within a tolerable range and usage of such powers might be in keeping with the expectations of citizen-taxpayers. It is critically important, therefore, to stress on taxpayers' rights in today's China since taxpayer-citizens have great motivation to monitor the way government uses their money. In order to do so, basic legal procedures from law-making to law enforcing to final judicial reviewing need to be effectively established in China in order to equip taxpayers with more realistic rights.

Possible Modifications

Modern tax law is characterised by two fundamental principles, "no taxation without representation" and "no taxation without law". It is not certain that these principles and their supportive legal instruments successfully developed in other countries will achieve the same success in China. But it is certain that some common features in modern tax theory, such as protecting taxpayers' fundamental rights to constrain government, can be drawn upon to reconstruct China's constitutional theory and modify China's legal understanding on taxation and its structures. But simply following the lead of other countries' patterns or copying them is not sensible or feasible. China must face up to its uniqueness including in its taxation system and focus on China's constitutional reality.

⁸⁹ Historically, traditional philosophers and economists sensed the weak points of politics and often showed little respect for politicians. David Hume clearly said: "in contriving any system of government . . . every man ought to be supposed a knave, and to have no other end . . . than private interest." John S. Mill echoed Hume: "the very principle of constitutional government requires it to be assumed, that political power will be abused to promote the particular purposes of the holder." See David Hume, "Of the Independency of Parliament" (1741) in *Essays Moral, Political and Literary, Liberty Classics* (Indianapolis: Liberty Classics, 1987), p 42; John S. Mill, "Considerations on Representative Government" (1861) in *Essays in Politics and Society* (Toronto: University of Toronto Press, 1977), p 505. Buchanan, disillusioned with the 18th century political wisdom on checks and balance to limit government, argued against the romantically idiotic notion that "as long as [political] processes are democratic all is fair game." See James M. Buchanan, "Constitutional Imperatives for the 1990s: the Legal Order for a Free and Productive Economy" in *Thinking about America* (Stanford, California: Hoover Institution Press, 1988), p 255.

⁹⁰ Certainly, we cannot rule out the possibility of significant interdependencies between fiscal constraints and other constraints, such as the constitutional rules that might be imposed through definition of election, legislative and judicial powers and so on. But this article will not seek to justify them, rather, to emphasise the fiscal one, which is, as analysed, the basic root for constitutionalism and is critical for today's China.

Some legal researchers have claimed that China should adopt and apply the principle of “no taxation without law” by including the principle in the Constitution.⁹¹ This would be an excellent step towards mending a very large flaw in the Constitution. Some economists also emphasised the importance of the principle.⁹² The more fundamental issue, however, is how to make the principle effectively function in reality.

This article suggests three reform steps, ie the beginning step (lawmaking), the middle step (enforcing), and the third step (legal remedy). First, in the lawmaking procedure, representatives to the NPC and each LPC should truly be elected by those people to whom they are ultimately accountable, which embodies the meaning “no taxation without representation”. This procedure calls for a reform in the election system provided by China’s current election law. There are many difficulties facing reformers in this area, like the relationship between the state and the Communist Party, increasing universal suffrage above the county level and so on. But through reforms in other constitutional systems, China may gradually boost reforms in the election law.

Second, the government and its agencies must be strictly subject to the provisions of tax laws stipulated by the NPC or the SCNPC.⁹³ When taxes have been imposed by legislatures, governments should have no rights to ask for other types of taxes via administrative fees unless these fees are personally charged for providing some specific services, such as issuing licenses. And, in such cases, any such fees should never be any higher than the amount needed to run the particular licensing system. That is, they should truly be a “fee for a service” – and not a “disguised tax”. Next, government budgets should be detailed and entirely clear with regard to revenues and expenditures. Additionally the budget must be open to the public for full scrutiny and discussion.

Further, the principle of “no taxation without law” shall be clearly stipulated in the Constitution. This principle implies two meanings. One is that only by law can taxation be imposed. The second is that laws concerning taxation

⁹¹ See Zhang Shouwen, “Lun Shui Shou Fa Ding Zhu Yi [On the Principle of No Taxation without Law]” (1996) 6 *Fa Xue Yan Jiu [Chinese Journal of Law]* 57–65; Wang (n 9 above).

⁹² Mao Yushi, “Shui Shou Yu Wen Ming: Shui Wu Wen Ming De He Xin Shi Yi Fa Zhi Shui [Taxation and Civilization: The Core of Taxation is No Taxation Without Law]” (2002) 9 *Zhong Guo Shui Wu [China Taxation]* 28; Cong Jiange, “Wo Guo Shui Shou Li Fa De Xian Fa Xue Fen Xin [Analysis of China’s Taxation Legislation from a Constitutional Perspective]” (2004) 6 *Shandong She Hui Ke Xue [Shandong Social Science]* 49–52.

⁹³ This means, tax laws must be legislated by the NPC or the SCNPC in accordance with China’s Constitution. Specific government regulations or implementation rules passed by government agencies concerning tax issues must be strictly in accordance with tax laws and the Constitution. In addition, taxation actions took by relevant officials or civil servants should also meet all requirements provided for by tax laws.

matters and taxpayers' rights protections are superior to other administrative regulations and rules.

Having the principle included in Constitution is the first step. Another equally essential principle, "taxation according to capacity", should be drafted into the income tax law at the same time. This principle embodies taxation equality.⁹⁴ Briefly speaking, it refers to the requirement that income taxes shall be in line with individual capacity, people with the same situation pay the same taxes and with different situations pay appropriately differing amounts of tax. This principle strongly challenges the traditional principle, "beneficiaries pay taxes", which means that whoever pay their taxes enjoys the government services, and the scope is in proportion to how much they pay. Indeed, the old principle represented a view of the supremacy of state sovereignty, which cannot be justified by modern constitutional theory. This approach of imposing taxes according to capacity helps to constitutionally protect private property. On the other hand the duty to pay demands equal sacrifice by citizens in the public interest. In this sense, even where a person pays only one cent tax, his or her payment has its constitutional meaning in law, that is, he or she has rights to enjoy government services.

Finally, a real legal remedy procedure should be provided for taxpayers through administrative laws such as the administrative litigation law, making it possible for taxpayers to file administrative actions to check up on whether or not the government has violated relevant tax laws, whether substantively or procedurally. Other legal disputes regarding public affairs, like environmental protection and city planning, should also be open to suit before a court of law by common citizens on the behalf of taxpayers because taxpayers have rights to oversee the way government spends their money. Thus, taxpayers' rights enable taxpayers to control the government's power and to force it to take actions legally as well as equally.

Conclusion

Tax, in essence, has a close linkage with citizens' private property rights and civil and political rights. A properly applied taxation system not only helps the government maintain itself but compels the government to do better to enhance people's welfare. The current problems in China's taxation system reveal a big flaw in its Constitution and reflect much false understanding about fundamental taxation principles. Kitano Hirohisa has pointed out that

⁹⁴ This principle was adopted after World War II by modern constitutional polities. See Ge Kechang, "Liang Neng Ke Shui Yuan Ze Yu Suo De Shui Fa [The Principle of 'Taxation according to Capacity' and the Income Tax Law]" in Ge (n 33 above), pp 115–130.

the taxation is no longer an unbridled option enjoyed by a despot, but the creature of laws.⁹⁵ It means that taxation must embody democracy and the “rule of law”.

China is transforming its socialistic planned economy into a market economy. Its legal traditions mean that citizens and even government officials lack an internalised sense of the “rule of law”: the government power is unlimited or at least, is hard to limit; common citizens, as direct or indirect taxpayers, have few legal rights to argue against the government’s unlawful actions on the behalf of taxpayers. Although researchers have given attention to such problems, there has been no comprehensive and systematic study of taxpayers’ fundamental rights. By studying, reforming and enforcing taxpayers’ rights in line with modern taxation theory we can take appropriate steps, in China, towards achieving limited government. The current individual income tax law of China has been modified at the end of 2005, with major changes introduced such as raising the tax threshold on wages and salaries, and providing a system of handling tax payment declarations by taxpayers themselves. Yet other problems, such as an inefficient tax-collecting system and tax evasion by high-income groups, still await solution. Until they are solved the ultimate goal of readjusting wealth distribution inequality will be difficult to achieve.⁹⁶ However, the reform of the income tax system is as much a means as an end. Its consequential effect will be to provide an important boost for the project to foster limited government in China.

⁹⁵ See Hirohisa (n 28 above), pp 15–22.

⁹⁶ See Lou Jiwei, “Ge Ren Suo De Shui Fa Jin Hou Jiang Ze Ji Quan Mian Xiu Ding [The Law on Individual Income Tax Will be Fully Modified in a Proper Time in the Future]” available at <http://finance.people.com.cn/GB/1037/3808335.html>.