

eJournal of Tax Research

Volume 15, Number 2
(Special Edition: Tax and Corruption Symposium)

December 2017

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Applying foreign anti-corruption law in the Chinese tax context: Conceptual difficulties and challenges

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Abstract

At the core of the international anti-corruption legislation that penalises companies in their home state for engaging in corruption extraterritorially. This article examines the application of the Chinese tax context. While the legislation rests heavily upon a finding that an extra-jurisdictional assumption that formal law is aligned with legitimacy is reasonable in many contexts and practical in the application of the law, a focus on legality does not align well with legitimacy in China. In China, vague laws are created by the central government in order to facilitate flexible and localised implementation. In a system where formal legal institutions are underdeveloped, informal rules are significant in guiding the actions of local officials. Australia ought to consider the nature of its extraterritorial jurisdiction.

Keywords: Local state corporatism; China; corruption; bribery; Chinese tax law; rule of law in China; vague and flexible law; rule of mandates; informal rules; legitimately due; competitive advantage; regionally decentralised authoritarianism; local experimentation

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1. INTRODUCTION

Corruption and bribery are regarded as highly undesirable and damaging phenomena. This is particularly thought to be the case in developing countries with weak institutions and, often, weak rule of law. As a result of concerns about bribery and corruption in developing countries there has been an international effort to curb them since the 1960s. This has been particularly aimed at preventing large multinational businesses from the developed world from engaging in bribery and facilitating corruption in the developing world. At the core of this international effort is the -corruption legislation that penalises companies in their home state for engaging in corruption extraterritorially.

of concern in the above context as they represent one of the major interfaces between the private and public sectors. Favourable tax treatment may provide a significant competitive advantage to a taxpayer while unfavourable tax treatment may impede success. Many countries have chosen to intervene in their economies through the use of taxation to encourage and discourage particular economic activities. Where this is the case, there is greater scope for the administrative process surrounding taxation to be corrupted.

The issue of corruption in China has received significant attention. Media, anecdotal

ongoing trade relations, it is important that Australian firms are able to understand with certainty the nature of these prohibitions.

This article uses the application of Australian foreign bribery legislation to the Chinese tax context to highlight the difficulties with typifying Chinese institutions as corrupt in general. In addition to this significant finding, the article achieves a subsidiary practical outcome of demonstrating the risks and issues Australian firms face in doing business in China. The article also provides information of a practical

Finally it must be noted that this article does not seek to justify truly corrupt practices on the basis that they are part of the manner in which things work in China. Rather the goal is to show conceptual difficulties in defining something as corrupt in the Chinese institutional environment. True corruption cannot be dealt with effectively if the environmental circumstances mean that it is not correctly identified by relevant laws.

2. THE TAXATION ENVIRONMENT IN CHINA

While China has enacted tax laws and regulations, these are far from conclusive in determining taxation outcomes for businesses.⁴ Despite dealing with complex taxation concepts, the laws are brief.⁵ *Enterprise Income Tax Law* of 2007 introduced the concept of a Controlled Foreign Company (CFC). This

when it can be found in the myriad legal and economic relationships possible in relation to corporate groups.

The lack of certainty inherent in Chinese written law is resolved through the interaction between taxpayers and tax officers.¹⁰ Courts are so rarely used that they cannot be considered a materially meaningful element in the current Chinese tax institutional context.¹¹ The interactions between a taxpayer and their tax office are decentralised. Taxpayers interact with the tax office in their relevant city or lower administrative level (China's provinces, municipalities, autonomous regions, and counties). This form of interaction provides significant certainty in administration but also results in a variety of outcomes across time and location.¹² The variety is inevitable given the decentralised decision-making and lack of interaction between offices in different locations. The lack of cooperation between tax offices across different locations is the primary reason for the variation in tax office performance measures and partly related to formal and informal ties to the local economy and its administrators. The overall tax office administrative hierarchy requires such decentralised local decision-making in order to function.¹³

The Chinese tax institutional context outlined above necessitates a significant degree of interaction

the local state. At the same time, the local state plays a significant role in governing China.¹⁶

Thus a taxpayer company such as a foreign investment enterprise may be granted highly favourable taxation treatment based on a range of factors discussed above. On the other hand, highly unfavourable taxation treatment may also be imposed on other taxpayers in ostensibly similar circumstances. In some circumstances the range of treatment may be argued to fall within the vague limits of the law. However, it has been documented that the treatment may clearly depart from the principles inherent in the law and only be justified on a significantly strained interpretation of certain words, if at all.¹⁷ It would not be remarkable for treatment to be granted that simply departs from the law. For example, an enterprise that is not in any way using advanced technology may be granted an incentive aimed exclusively at those using advanced technology. Recourse to default and deemed assessments allows significant scope for administrators to simply determine a total tax burden for particular taxpayers.¹⁸ Finally, in cases where taxpayers are not generally granted the full benefit of a particular provision of the law, a taxpayer may be favoured by being granted it. For example, the law on Value Added Tax allows for the full refund of input credits on exported goods but this is not routinely given in China. Therefore a taxpayer can be favoured by being afforded the legal treatment.

3. CORRUPTION: THE AUSTRALIAN LAW

The context described above certainly indicates at least significant potential for corruption. However, it also indicates a lack of clarity in respect of where and when

The offence refers to the provision of an *advantage that is not legitimately due* as well as benefits that are *not legitimately due*.²² *illegitimate advantage* *improper advantage* set out in Article 1(1) of the Convention.²³

Section 70.2 can be simplified into the following components:

1. to provide a benefit that is not legitimately due;
2. to influence a public official;
3. to obtain an advantage that is not legitimately due.

3.1 Defences to section 70.2

informed by the broader statutory context. As such, sections 70.3 and 70.4 may assist in the interpretation of section 70.2.²⁴ These are briefly considered below.

decisions relating

³¹ Therefore such decisions are excluded despite the fact

³² It

would therefore appear that this defence would generally not be available in relation to tax treatment.

3.2 The meaning of legitimacy

³³ The Explanatory Memorandum to the Criminal Code Amendment

³⁴ Ordinarily, an act that is illegal will be considered to be ill

³⁵ The Explanatory

³⁶ The narrow interpretation adopted by the Explanatory Memorandum to the Bill is supported by the Commentaries relating to the *Convention on Foreign Bribery*.³⁷ Finally it has been argued that the perception that the must also be disregarded.³⁸ The rationale behind this narrow interpretation is that any

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3.3 The ordinary meaning of 'legitimately due' in the context of academic discourses on corruption

The Explanatory Memorandum to the Criminal Code Amendment (Bribery of Foreign given its ordinary meaning.⁴⁰ In view of the context, it is appropriate to have regard to Corruption is the subject of considerable debate among scholars.⁴¹ Various approaches

³¹ *Criminal Code*

of norms must be motivated by private interest.⁵⁰ This approach is also known as the legal definition of corruption. Academic commentary on the norms-based approach

different approaches to reach concluded views on the operation of those regimes in China.

3.5 China's unclear legal system

Within a taxation context, a rule of law system allows for the rights and obligations of a taxpayer to be readily ascertained.⁵⁷ As such, obligations are assumed to be ⁵⁸ to restrain the power of its administrative bodies. In doing so, the system limits the capacity of an administrator to consider the individual circumstances of a taxpayer.⁵⁹ e of law system.⁵⁶

3.5.1 Law

of government it emanates. Furthermore, the validity of a normative document may be unclear where it operates to contradict the original law.⁷⁰

Due to the variable economic environments of each locality, regionally-based pronouncements may conflict with one another.⁷¹ For example, as one district experiences economic overheating in its housing market and attempts to stifle demand, another may be suffering from falling house prices. In these circumstances, contradictory interpretations of a body of real estate law would be issued by regional governments.⁷² It follows that th

be considered a policy choice of the central government. Ambiguous national law invites discretion, and hence the application of flexible policy. Significant discretion is afforded to localities due to the information asymmetry that exists in relation to a

⁷³ Ultimately, guidance documents fail to fully

Income Tax Law, numerous normative or guidance documents exist. These have created a confused hybrid of administrative-legislative direction. How do these documents interact and what determines their priority? Again, the Chinese approach to resolving these tensions diverges from that of

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that set out how the tax office has interpreted a set of laws.

of normative documents as outlined above but more generally arise in the context of complex social relationship networks and hierarchies.

processes that must be followed to achieve them.⁹¹ In other words, only modest direction is provided to officials.

The above characteristics pose significant problems for an objective inquiry into . For example, is a tax incentive granted in contradiction to the formal law an illegitimate advantage? In this . Here, the local official has subordinated their mandate to collect central government revenue in favour of their mandate to stimulate the local economy. Whether this advantage is over their own fiscal revenue streams. As the mandates themselves are often not publicly disclosed, substantial evidentiary difficulties arise in making this determination.⁹²

-regional differences. The

an *absolute*
China.¹⁰¹
law.¹⁰²

relative standard in

-local legal relations. A simple formalistic application of results. Ultimately, in the absence of a rule of law system, formal legality is an inappropriate benchmark by which to gauge whether an advantage is legitimately due to a third party.

Australian private enterprise operating in China should not constitute conclusive evidence of criminal liability under the *Criminal Code Act 1995*.

3.7 Determining legitimacy by focusing on the administrative decision-maker

In view of the difficulties inherent in determining legitimacy in China by focusing on formal law, an alternative approach is to focus on the administrative decision-maker. However, such an exercise also presents significant difficulties in China. The role of a

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Local officials in China adopt a dual identity. They are simultaneously a state political agent to the central government and a local economic principal of their locality.¹⁰⁴

administrative discretion was eliminated in order to strengthen the Chinese
¹⁰⁹ The State maintained a system of vertical leadership (*chuzhi lingdao*) that ensured that all decisions were made at the top. Local officials functioned as mere agents of a paternalistic state.¹¹⁰ Prior to the reform, if a local official did the equivalent of providing an illegal tax advantage to a foreign firm they would have been accused of localism.¹¹¹

After 1978, the State began to devolve central power to local arms of government.¹¹² The motivation for the diffusion of central power was to provide fiscal incentives for local governments to pursue economic growth.¹¹³ Prior to 1994 local regions benefited from a decentralised tax revenue system.¹¹⁴ Additionally, local officials were provided freedom to approve private investment projects within their region.¹¹⁵ As such, local officials were transformed from being *unproductive* political entrepreneurs into *productive* economic entrepreneurs.¹¹⁶ This reform process led to the creation of

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4. CENTRAL ADMINISTRATIVE POLICY AND LEGITIMACY

Corruption is traditionally understood to have debilitating effects for the economic development of a country.¹³⁴ Extra-legal decision-making (say, formal illegitimacy) is developmental and facilitates economic growth.¹³⁵ Chinese officials disregard formal law to facilitate the creation of an efficient market system. In addition, they use an informal, alternative approach to governance in order to generate market certainty for investors.¹³⁶

The form of local governance has developed within the context of institutional transition to a market economy.¹³⁷ Local officials draw on *Guanxi* (relationship) business activity.¹³⁸ During this process, they facilitate a more efficient allocation of resources.¹³⁹ With the strengthening of formal law, formal illegitimacy will gradually become complete.¹⁴⁰ In order to understand extra-legal decision-making, it must first be acknowledged.

instrumental use of such compensation, has acquiesced to the situation and ultimately institutionalised it.¹⁴⁶

The context is further complicated by the fact that the central government has historically used anti-corruption policy as a macroeconomic management tool. Rather than implementing uniform anti-corruption measures, corruption campaigns have historically been employed by the central government in order to stifle inflation.¹⁴⁷ Such selective enforcement of anti-corruption laws suggests a disinterest in the inherent quality of the behaviour that is proscribed. During an anti-corruption campaign, local officials face the prospect of criminal punishment rather than mere internal disciplinary action.¹⁴⁸ Each of the four major anti-corruption campaigns between 1981 and 1997 coincided with the introduction of macroeconomic austerity policies.¹⁴⁹ The former General Secretary of the Chinese Communist Party has acknowledged that in orde

¹⁵⁰ During periods of political calm, the central government has been tolerant of corrupt activity.¹⁵¹ The use of corruption as a macroeconomic policy instrument diverts the focus from the inherent quality of the proscribed act itself.

The above factors add further to the difficulty in characterising the actions and decisions of officials as illegitimate in the Chinese context.

4.2 Experimentation, subsequent control and legitimacy

The role of regulation and law in China has been significantly different to its role in other places. A final significant aspect in this regard is the manner in which regulation can be experimental and officials can be retrospectively rewarded for departing from the rules. This is again highly significant for defining a departure from formal law, currently or historically, as illegitimate.

Since the start of the transitional period, the central government has created incentives for experimental governan

¹⁵² local officials to compete with neighbouring regions to achieve efficient outcomes for ¹⁵³ This process is known as experimental governance.¹⁵⁴ Within this -local relationship provides local government with significant autonomy to innovate.¹⁵⁵ -

¹⁴⁶ Ibid 201.

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(2007) 16(50) *Journal of Contemporary China* 65, 65.

¹⁴⁸ Melanie Manion, *Corruption by Design* (Harvard University Press, 2004) 168.

¹⁴⁹ Fubing Su and Dal

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of governance.¹⁵⁶ In an interdependent system, the costs of an unsuccessful regional reform will be borne by the system as a whole. It follows that reform. That is, economic reform initiatives can be initiated by the central government only.¹⁵⁸

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During the reform, local experimental governance allowed the Chinese Communist Party to pursue market reform without political ramifications. Movement towards a capitalist market economy was in conflict with the traditional communist ideals of the Party. Through maintaining its Marxist ideals while reaping economic gains from a newly developed market system. Former Chinese Communist Party chairman Deng Xiaoping described *mozhe shitou guohe*).¹⁶⁰ Through the use of this idiom, Deng Xiaoping appears to have been actively encouraging otherwise unsanctioned experimental methods of incremental reform.

An early example of local experimental reform was the development of Township and . In 1988 Deng Xiaoping hailed the advent of TVEs, acknowledging that the Chinese Communist Party was initially unaware of their development.¹⁶¹ As they departed from the established institutional framework.¹⁶² government innovation was the development of the 1980s foreign exchange swap market.¹⁶³ As with TVEs, due to their success, local foreign exchange swap markets were retrospectively legalised.¹⁶⁴

Notably, only successful reform experiments were given the retrospective approval of central government.¹⁶⁵ from the lawful administration of a locality. This aligns with contemporary observations that the central government will allow for significant exploitation of a

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As part of the experimental process, local governments were vulnerable to allegations of corruption and lived in fear of the central government.¹⁶⁷ Selective tolerance of an politically loyal to the State.¹⁶⁸

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