IS CHINA IN THE INTERNATIONAL TAX COMPETITION ARENA?

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Executive Summary

1. Many countries are competing for foreign direct investment (FDI) inflows, driving international tax competition upwards and tax rates on mobile international capital downwards.

2. Multinational companies could minimise and avoid tax through the relocation of mobile capital. Taxes are one main area considered by multinational companies when establishing their foreign subsidiaries.

3. Since its 1978 economic reform, the Chinese government has provided considerable tax incentives to promote economic development, encourage foreign investment, and introduce advanced technologies and equipment from overseas.

4. As its economy picks up, the Chinese government is re-thinking its tax policies in relation to the corporate tax incentives it has granted to foreign enterprises.

5. The regional tax incentives have further widened the gap in regional development, negatively impacting on the improvement in the industrial structure.

6. Some foreign-invested enterprises (FIEs) have shut down their initial operations after their tax incentives expired in the special zones and restart them elsewhere to enjoy a new set of tax incentives.

7. The introduction of resident enterprises implies that China's tax policy is harmonising with international practice.

8. A striking feature of the new enterprises' income tax system has been the steady increase in the enterprises' income tax revenues.

9. FIEs minimise their tax burden through transfer pricing or the use of lower-tax jurisdictions.

10. Tax incentives are generally not sufficient to attract major flows of investment. China is not a low tax country, but rather a recipient of substantial FDI inflows.

11. Most of China's inward FDI comes from the East Asia region, with Hong Kong and Taiwan accounting for the lion's share. Therefore, a triangular trade pattern has emerged.

12. The general economic and structural conditions rather than corporate tax incentives are far more important in determining FDI inflows in China.