

## NOTES

### THE JOINT VENTURES LAW OF THE PEOPLE'S REPUBLIC OF CHINA<sup>1</sup> IN A LEGISLATED AND NEGOTIATED TAX CLIMATE

#### I. INTRODUCTION<sup>2</sup>

The People's Republic of China (PRC) faces several major economic challenges, including shortages of capital, foreign exchange, advanced technology, and skilled labor.<sup>3</sup> Considered a

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1. The Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment, *reprinted in* 29 THE BEIJING REVIEW 22, 22-24 (1979) (hereinafter cited as JVL).

2. The officially adopted pinyin system of writing Chinese characters in the English alphabet, rather than the traditional Wade-Giles romanization system, is used in this report. As an example, "Beijing" instead of "Peking" is used here.

3. For a country whose recent economic history shows it to be a creditor nation with an excellent credit rating, despite having 85 percent of its population of over one billion characterized as rural, the financing requirements of the PRC's most recent ten-year plan (to be concluded in 1985) will exceed by \$5 billion its \$20 billion government-subsidized credits from foreign countries and its \$4.5 billion in foreign currency and gold reserves. H. CAHILL, *THE CHINA TRADE AND U.S. TARIFFS* 133 (1973); speech by Lynn Feintech of the Bank of America at the New York Law Journal seminar conference on "How to Do Business in China" presented on December 13 and 14, 1979 in Los Angeles, California ( *in part reprinted in* 287 U.S. EXPORT WEEKLY (BNA) C-1 (1978); J. KREPS, M. McMILLAN AND F. WEIL, *ATTITUDES OF THE PEOPLE'S REPUBLIC OF CHINA TO INTERNATIONAL COMMERCIAL TRADE* B-44 (1979) (hereinafter cited as *ATTITUDES*). William P. Alford, Esq., an expert in PRC affairs, in a speech at the October, 1979 Federal Bar Association annual convention in Washington, D.C., stated that the greatest impediment to the PRC as a poor country is its inability to pay for goods and technology despite the country's fine reputation for credit worthiness. 277 U.S. EXPORT WEEKLY (BNA) C-1 (1979). *See also* M. FENG-HWA, *THE FOREIGN TRADE OF MAINLAND CHINA* 186 (1971).

Rong Yiren, head of the newly formed China International Trust and Investment Company (CITIC) and employed to attract prospective foreign partners to the PRC and implement joint venture agreements, expects the PRC to experience a large deficit while trying to accommodate Chinese enterprises' "desperate" pleas for an infusion of foreign funds. *Wall St. J.*, Nov. 14, 1979, at 1, col. 5.

"Desperate" is a mild indication of the financing needs of the PRC, according to one estimate, if it is to accomplish its economic goals by the beginning of the twenty-first century. That estimate shows that the cost of the large-scale plan will reach \$350 billion by 1985, of which \$50 billion must originate from outside the PRC. *ATTITUDES* at 26.

Countries such as the United States have expressed an interest in making considerable extensions of credit to the PRC for the development of joint ventures and other enterprises, as well as general development of the Chinese economy. United States Vice President Mondale in a speech in Beijing on August 27, 1979 declared that the United States is willing to support a \$2 billion, 5-year line of credit of United States Export-Import Bank trade credits for the PRC and pledged Overseas Private Investment Corporation

(OPIC) guarantees to develop power plants in the PRC, 271 U.S. EXPORT WEEKLY (BNA) C-1 (1979). Support from those two organizations would allow United States business entities to compete most effectively with enterprises from other countries seeking business in the PRC.

Except for Commodity Credit Corporation (CCC) agricultural credits, the PRC does not enjoy the benefit of access to Export-Import Bank loans or guarantees, ATTITUDES at 23, B-1 (citing the Agricultural Trade Act of 1978, which permitted the CCC to finance U.S. exports to China notwithstanding restrictions under § 402a and b of the Trade Act of 1974, and the Jackson-Vannik amendment which provides that the Export-Import Bank shall not offer financing to any country that denies or provides an impediment of an individual's right in that country to emigrate.) In addition, the provisions of the Foreign Assistance Act of 1971 restrict U.S. foreign aid via organizations such as OPIC when communist countries receive the aid.

In order to alleviate the restrictions on these two sources of financing, President Carter filed an executive order which waived the § 402a and b requirements for the PRC. Offering further support for the PRC, Senator Jackson, co-author of the Jackson-Vanik amendment, stated that the PRC has fully complied with the requirements of the law in permitting free emigration of PRC citizens, 280 U.S. EXPORT WEEKLY (BNA) A-1 (1979). In addition, the Javits-Bingham bill was introduced to exempt OPIC from the Foreign Assistance Act of 1961 provisions, *id* at A-8.

A third hurdle to be overcome is the Johnson Debt Default Act of 1934, which prohibits financial interactions between the United States and countries which are in default of obligations due the United States government. ATTITUDES at 23; Surrey, *Growth and Outlook for U.S.-China Trade*, in LEGAL ASPECTS OF DOING BUSINESS IN CHINA 17 (H. Holtzmann ed. 1976); Denny and Stein, *Recent Developments in Trade Between the U.S. and the P.R.C.: A Legal and Economic Perspective*, 38 L. & CONTEMP. PROB. 260, 265 (1973); Li, *Trade with China: An Introduction*, in LAW AND POLITICS IN CHINA'S FOREIGN TRADE 19 (V. Li ed. 1977). Negotiations between the U.S. and the PRC over frozen assets and debt obligations were expected to be resolved in 1980, Wall St. J., Oct. 1, 1979, at 6, col. 2.

Despite legal hurdles being confronted on the matter of obtaining U.S. financing for the PRC, economic hurdles present something of a challenge. Notwithstanding the provisions of the Sino-U.S. Trade Agreement at note 4 *infra*, both Export-Import Bank and OPIC standards must be met. According to J.M. Duff, Deputy General Counsel for the Export-Import Bank, that bank must reach an understanding with the PRC on matters of spelling out Chinese procedures for determining the priority of projects to be funded and historical data on the PRC economy must be provided to the bank. 281 U.S. EXPORT WEEKLY (BNA) C-1 (1979); 287 U.S. EXPORT WEEKLY (BNA) C-1 (1979). In response to these requirements, Chinese Foreign Trade Minister Li Qiang was subtly disappointed, 281 U.S. EXPORT WEEKLY (BNA) C-1 (1979). With a similar response Chinese Premier Gu Mu stated that his country is ready to accede to United Nations financial organizations' requests, and would accept loans from international financial entities such as the World Bank or from "friendly" countries and financial organizations, but that such acceptance would not affect Chinese "sovereign rights" and the terms would be "appropriate", 276 U.S. EXPORT WEEKLY (BNA) C-1 (1979).

In the matter of employment, PRC Communist Party Vice Chairman Li Xian-nian said to New York City Mayor Koch that, despite the successful effort to place 8 million unemployed Chinese workers in 1977, the PRC is currently faced with and views as unsolvable the additional 10 million unemployed Chinese workers in 1980, Syracuse Herald-American, Feb. 26, 1980. It is apparent, however, that the level of management ability of those unemployed workers does not meet the current 10-year plan. One of the reasons given by the PRC leaders in reducing expectations for the current 10-year plan was a lack of a competent middle management, Alford, *supra* note 3 at C-2.

developing country,<sup>4</sup> this most populous nation<sup>5</sup> has affirmed a goal of becoming a world industrial leader by the beginning of the next century.<sup>6</sup> Its tradition of self-reliant commerce<sup>7</sup> has commensurately yielded to a legislated commitment permitting domestic investment<sup>8</sup> by foreigners.

The Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment<sup>9</sup> (JVL) was adopted by the Second Session of the Fifth National People's Congress on July 1, 1979 and became effective on July 8, 1979.<sup>10</sup> The PRC initiated the law with the objectives of developing certain vital areas of its

4. In the Trade Agreement Between the United States and the People's Republic of China, Art. II, § 3, *reprinted in* 265 U.S. EXPORT WEEKLY (BNA) N-1 (1979) (hereinafter cited as Trade Agreement), the PRC is referred to as a "developing country." Among numerous texts supporting this contention, *see also* ATTITUDES, *supra* note 3, at B-44; PRICE, WATERHOUSE & CO., *DOING BUSINESS WITH THE PEOPLE'S REPUBLIC OF CHINA* 5-6 (1979); Liang-Shing, *The Economy and Foreign Trade of China*, 38 L. & CONTEMP. PROB. 249 (1973). (1973).

5. INFORMATION PLEASE ALMANAC 110 (1980).

6. *See* ATTITUDES, *supra* note 3, at B-1; Lubman, *Trade Between the United States and the People's Republic of China: Practice, Policy and Law*, 8 L. & POL'Y IN INT'L BUS 1, 16 (1976).

Chinese Premier Hua Guofeng is committed to the steady development of China's modernization program; however, he has expressed disappointment in certain lagging Chinese industries. Attributing the blame to the Gang of Four, Premier Hua has indicated that some of the goals could be too ambitious due to lack of funds and a competent middle class as well as the higher priority of military and agricultural projects. 277 U.S. EXPORT WEEKLY (BNA) C-2 (1979). A three year adjustment beginning in 1979 is expected. ATTITUDES, *supra* note 3, at 27. Already foreign contracts variously estimated in value between \$2.5 billion and \$3 billion have been suspended. *Id.* at 26.

7. The concept of self-reliance was most emphasized during the era of Mao Zedong, Luban, *supra* note 6, at 15. The concept should be limited, however, to reflect the foreign trade objectives of the PRC at the time: meeting the needs of domestic economic development and of the people's livelihood rather than exploiting markets and earning profits, *Legal Aspects of China's Foreign Trade Practices and Procedure*, 12 J. INT'L L. & ECON. 105, 107 (1977-78). *See also* Li, *Trade With China: An Introduction*, in *LAW AND POLITICS IN CHINA'S FOREIGN TRADE*, 19 (V. Li ed. 1977).

8. Drafters of the JVL were careful not to include the word "ownership" in the law. According to Article 5 of the Constitution of the PRC, the only two forms of ownership recognized in the PRC are socialist ownership by the whole people and social collective ownership by the working people, Swain, *Law in China After 46 Years, The Chronicle* (published by the University of Illinois Law School at Urbana-Champaign, Fall, 1979). Foreign ownership through joint venture in the PRC develops out of contractual rights and duties due the foreign partner such as a portion of the profits of repatriation of capital, ATTITUDES, *supra* note 3, at 14.

9. JVL, *supra* note 1.

10. *Id.*

economy<sup>11</sup> and of strengthening its alignments with other nations.<sup>12</sup> The law was enacted to facilitate the country's modernization program<sup>13</sup> by importing modern plants and technology without having to draw on significant amounts of capital or credit.<sup>14</sup> The PRC is apparently determined to build a solid economic base and improve its standard of living by allotting greater priority to commercial agreements with foreign investors.<sup>15</sup> It is developing legal norms, causing foreigners to begin to feel greater assurance concerning the security of investment there. The JVL and its accompanying tax laws and regulations represent a balancing by the PRC between deliberately seeking foreign investment and incorporating western ways and the Chinese tradition of non-legal business practices.<sup>16</sup> It signals

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11. The most likely concentration of joint venture investment, according to CITIC head Rong, will initially be in hotels, light industry, textiles, nonferrous metals, coal, mining machinery, and transportation equipment, 278 U.S. EXPORT WEEKLY (BNA) C-2 (1979).

12. In its commercial transactions, the PRC has historically concentrated on economic rather than political results. CAHILL, *supra* note 3; Li, *Trade with China: A Cautionary Prospectus*, in CHINA'S TRADE WITH THE WEST 228 (A. Stahne ed. 1972). In talks with United States Secretary of Defense Brown on the flow of U.S. technology to the PRC, however, Premier Hua contentedly communicated the discomfort China's neighbors, the Soviet Union and Vietnam, feel over the strengthening of Sino-U.S. relations.

A poignant statement from a high ranking Chinese official on the relationship between economies and politics comes from Ahao Aiyang, the Governor and Communist Party First Secretary of the Province of Sichuan, in a speech given in the fall of 1979:

We must not bind ourselves as silkworms do with cocoons. . . . All economic patterns and conventions which hold back development of productive forces should be abolished. Economic work is the central work of the whole party at present and is itself the most important politics.

Syracuse Herald, Jr., Feb. 17, 1980, at 27, col. 1.

13. The "Four Modernizations" of the PRC - science and technology, industry, agriculture, and defense - are the areas of greatest emphasis for development over the next twenty years, ATTITUDES, *supra* note 3, at 3.

14. Wall St. J., June 13, 1979, at 14, col. 2.

15. *Id.*

16. The first shock to a lawyer beginning his involvement with China is that China does not have an established, coherent framework of laws or regulations relating to contracts, the sale of goods, dispute resolution, etc. (i.e. matters which govern legal rights and duties arising out of commercial agreements). In effect, the only governing law between China and a foreign party is the actual contract between the parties.

ATTITUDES, *supra* note 8, at 1. See also Lubman, *supra* note 6, at 1; Edwards, *The Legal Framework of Chinese Trade*, in LEGAL ASPECTS OF DOING BUSINESS WITH CHINA 63 (H. Holtzmann ed. 1976). Though some regulations and statutes exist in this area, Lubman, *supra* note 6, at 2, the Chinese generally tend to weaken legal formalities and to shift legal functions away from the specialized structures officially designed to perform them. J. TOWNSEND, POLITICS IN CHINA, 315-316 (1974) *in part reprinted in Shaney, Selected Legal Aspects*

that the PRC is becoming more sensitive to market forces in setting national policy.<sup>17</sup>

This Note will examine the JVL as a new law in a society historically hesitant to structure its business dealings with a legal framework<sup>18</sup> or to allow outsiders access to domestic investment.<sup>19</sup> In the context of the Chinese policy to expand international commercial agreements and technical capabilities, this Note will further focus on the impact of The Income Tax Law of the People's Republic of China Concerning Joint Ventures With Chinese and Foreign Investment<sup>20</sup> (JVTL) and The Detailed Rules and Regulations For the Implementation of the Income Tax Law of the People's Republic of China Concerning Joint Ventures With Chinese and Foreign Investment<sup>21</sup> (JVTR) on a culture which has preferred

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*of China's Conduct of Foreign Trade*, 11 INTL LAW. 641, 642 (1977). "The Chinese conception of law as an internalized mode of structuring, or at least influencing, behavior has been characterized, by western legal standards, as reflecting a legal posture ranging from indifference to lawlessness." Shaney, *supra* at 642. See also Theroux, *Exporting to China: Practical Legal Problems*, in LEGAL ASPECTS OF DOING BUSINESS WITH CHINA, 119, 122 (H. Holtzman ed. 1976). The role of an attorney in business matters has been characterized as superfluous by the Chinese, Torbert, *The American Lawyer's Role in Trade with China*, 63 A.B.A. J. 1117 (1977), given the Chinese historical concept of law as informal and unwritten, Shaney *supra*.

After the rule of the Gang of Four ceased in the fall of 1976, however, the role was significantly renewed. A new constitution was initiated, and legal conferences and codification and reform of statutes were underway under the leadership of the Chinese Communist Party Central Committee, ATTITUDES, *supra* note 3, at 3. The JVL and provisions to adopt an economic law are some of the products of this revitalized legal effort in the PRC. For a history of China's legal system, see ATTITUDES, *supra*, note 3, at 2-4.

17. Wall St. J., June 13, 1979, at 14, col. 2. Concerning the incorporation of market forces and material incentives in the PRC's centrally planned economy, Vice Premier Li Xian-nian succinctly states his philosophy:

If you do more, you get more; if you do less, you get less; if you don't work at all, you get nothing. We think that only by so doing you can possibly fire the enthusiasm of workers.

Wall St. J., Nov. 20, 1979, at 24, col. 4.

18. See note 16, *supra*.

19. No direct investment has been allowed in the PRC since 1950, ATTITUDES, *supra* note 3, at B-44, however, the Chinese have been involved in "overseas" joint ventures in a few instances during that time. See *id.* at 14.

20. The Income Tax Law of the People's Republic of China Concerning Joint Ventures with Chinese and Foreign Investment, 1980, unofficial translation reprinted in 326 U.S. EXPORT WEEKLY (BNA) M-1 (1980) (hereinafter cited as JVTL).

21. The Detailed Rules and Regulations For the Implementation of the Income Tax Law of the People's Republic of China Concerning Joint Ventures With Chinese and Foreign Investment, 1980, unofficial translation reprinted in 3 E. ASIAN EXEC. REP. 24-26 (1981) (hereinafter cited as JVTR).



negotiations of laws and rules between business partners and which has permitted such flexibility to spill over into these new laws.

## II. THE LANGUAGE OF THE JVL

A joint venture<sup>22</sup> may be initiated in the PRC by any number of foreign companies, enterprises, or similar economic entities or individuals incorporated with any number of Chinese companies, enterprises, or similar economic entities.<sup>23</sup> Applications are filed by the prospective parties of the joint venture through the Foreign Investment Commission of the PRC<sup>24</sup> for authorization of agreements, contracts, and articles of incorporation and then through the General Administration for Industry and Commerce for licensing registration.<sup>25</sup>

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22. A joint venture may be defined as

[A] form of temporary partnership organized to carry out a single isolated business enterprise for profit, and usually, although not necessarily, of short duration. It is an association of persons who combine their property, money, efforts, skill, and knowledge for the purpose of carrying out a single business operation for profit.

L. SMITH AND G. ROBERTSON, BUSINESS LAW: UNIFORM COMMERCIAL CODE, 736-7 (3rd ed. 1971) *in part reprinted in* J. KOSNIK, NATURAL GAS IMPORTS FROM THE SOVIET UNION-FINANCING THE NORTH STAR JOINT VENTURE PROJECT, 12 (1975).

23. JVL, *supra* note 1, at art. 1. Note that a Chinese individual may not independently enter into a joint venture with a foreign entity or individual. Perhaps this reflects the policy of ownership in the PRC, *see* note 8 *supra*.

For an analysis of the expectations and problems surrounding government participation in joint ventures, *see generally* Chandler, *Private Foreign Investment and Joint Ventures*, in PRIVATE FOREIGN INVESTMENTS AND THE DEVELOPING WORLD, 207, 209 (P. Ady ed. 1972); K. BIVENS AND E. LOVELL, JOINT VENTURES WITH FOREIGN PARTNERS, 33-34, 47-50 (1966).

24. That commission has also been referred to as the Foreign Investment Control Commission of the PRC, *see* Surrey and Soble, *Joint Venture Law and Dispute Resolution in China: A Framework for International Trade*, 1 E. ASIAN EXEC. REP. 3, 14 (1979) (hereinafter cited as *Framework*).

25. Joint Venture Law, *supra* note 1, at art. 3. Gu Mu, head of the Import-Export Control Commission and the State Capital Construction Commission which oversees all major Chinese investment projects, is the head of the Foreign Investment Commission, Wall St. J., Aug. 1, 1979, at 6, col. 3. *See also* note 26 *infra*.

Preliminary organizational steps by the foreign investor in locating a partner in the PRC must be implemented through the Chinese International Trust and Investment Corporation (CITIC).<sup>26</sup> The function of CITIC is to attract foreign investment and to match it with Chinese organizations.<sup>27</sup> It assists in negotiating terms of the joint venture agreement and in raising foreign loans. It may also initial accords and preliminary agreements on proposed joint ventures with foreign companies.<sup>28</sup>

The foreign investor may have to realign a few of its notions of corporate organization and decision making to meet the requirements of the JVL. There are, however, broad policy matters consistent with general business practices. For example a foreign business partner is allowed significant discretion in the amount of registered capital<sup>29</sup> it contributes to the joint ven-

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The law sets a maximum time limit of three months in which the foreign Investment Commission must act on the proposed joint venture documents, JVL, *supra* note 1, at art. 3. Given the history of Chinese negotiations, protracted and detailed negotiations prior to completion of the appropriate forms can be anticipated. *Framework, supra*, note 24 at 14. For a review of negotiating techniques of the Chinese and recommendations on how to approach them, see generally ATTITUDES, *supra* note 3, at B-6, B-13, B-14; PRICE, WATERHOUSE & CO., DOING BUSINESS IN THE PEOPLE'S REPUBLIC OF CHINA, 13-14 (1979); DOING BUSINESS WITH THE PEOPLE'S REPUBLIC OF CHINA, 43-57, 74 (1973); 287 U.S. EXPORT WEEKLY (BNA) C-5 (1979); Wall St. J., May 15, 1979, at 8, col. 2.

26. Wall St. J., Nov. 14, 1979, at 1, col. 5 It may not be required in the future that foreign joint venture candidates must initiate contacts through CITIC, *id.*

CITIC is a quasi-government company whose general manager is Rong Yiren, *id.* Considered the PRC's first "capitalist" organization, *id.* at 39, Mr. Rong is likened to a government minister, *id.* He is responsible to the PRC State Council which is headed by Premier Hu, 278 U.S. EXPORT WEEKLY (BNA) C-2 (1979).

CITIC is assisted in the United States under a working relationship with the First National Bank of Chicago, Wall St. J., Nov. 14, 1979, at 1, col. 5. The address is:

First National Bank of Chicago  
One First National Plaza  
Chicago, Illinois 60770  
(312) 732-4000

See also note 25 *supra*.

27. 278 U.S. EXPORT WEEKLY (BNA) C-2 (1979).

28. Wall St. J., Oct. 5, 1979, at 20, col. 1.

29. The term "registered capital" means the capital contributed by either party and may consist of cash, capital goods, industrial property rights and technology, and the right

ture.<sup>30</sup> The maximum duration of a joint venture is not specified in the law.<sup>31</sup> Business risks are divided among the partners in proportion to the capital contribution,<sup>32</sup> and alienation is limited by the consent of the other parties.<sup>33</sup> Affiliated agencies may be established outside of the PRC.<sup>34</sup> No restrictions are specified on the amounts of compensation.<sup>35</sup>

Incentives exist for redeposit of profits of the venture,<sup>36</sup> for boosting reserve funds,<sup>37</sup> bonus plans,<sup>38</sup> welfare funds,<sup>39</sup> and expansion funds,<sup>40</sup> and for quality of technology.<sup>41</sup> In addition, Chinese of-

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to use the plant situs. JVL, *supra* note 1, at art. 5. Generally, the foreign partner's contribution of capital shall not be less than 25% of the total, *id.* at art. 4.

Some legal discussion has been raised over the maximum amount of registered capital which a foreign partner may contribute. One source states the maximum amount to be 49 percent but may be extended provided the joint venture is engaged solely in the production of goods to be exported. ATTITUDES, *supra* note 3, at 14. Another source reasons that despite no specific ceiling, the law does not provide for 100 percent foreign participation since the investment would no longer constitute a joint venture. Framework, *supra* note 24, at 14. Vice Premier Deng Xiaoping, however, declared at the time the JVL became effective that although the contribution limits for foreign partners had been set at 25% to 49%, the PRC would entertain a 100% registered capital contribution, 264 U.S. EXPORT WEEKLY (BNA) C-1 (1979).

30. *Id.*

31. The formula for determining the duration of the joint venture is by agreement among the parties, JVL, *supra* note 1, at art. 12. The joint venture may be further extended with agreement among the parties and approval by the Foreign Investment Commission of an application submitted at least six months before the expiration of the contract, *id.* The duration of the venture could exceed a ten- to twenty-year period, Wall St. J., Aug. 1, 1979, at 6, col. 2.

For an account on the transitional nature of joint ventures, see generally, L. FRANKO, JOINT VENTURE SURVIVAL IN MULTINATIONAL CORPORATIONS 198 (1971).

32. JVL, *supra* note 1, at art. 4.

33. *Id.*

34. *Id.* at art. 9.

35. Recently, the Chinese have been demanding a higher rate for Chinese labor than actually paid by the enterprise to the workers. The Chinese justify this by stating that the actual wage paid is only part of the compensation received by the worker; that the worker and his family also receives subsidized education, medical and dental care, housing, etc. Notwithstanding this position, the Chinese have indicated that their labor costs will be competitive.

ATTITUDES, *supra* note 3, at 14.

36. JVL, *supra* note 1, at art. 10.

37. *Id.* at art. 7.

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.*



officials have made claims of favorable returns and reduced administrative red tape on behalf of joint venture partners.<sup>42</sup>

Limitations in certain areas may cause some concern for the foreign investor. For example, the Chinese partner may in some instances consider the right to use the plant situs in determining its contribution to the registered capital.<sup>43</sup> In such cases, the foreign partner has no part in assessing the value of the right.<sup>44</sup>

In addition, the corporate structure of the joint venture must include a Chinese chairman of the board, although one or two vice-chairmen may be appointed by the foreign investor.<sup>45</sup> Directors shall be selected or removed by the partner whom the directors represent.<sup>46</sup> Replacement of personnel has been known to result in delay of decisions or negotiations by the Chinese.<sup>47</sup>

The decision making process is described in the law as one of consensus and consultation among board members under principles of equality and mutual benefit.<sup>48</sup> Confrontation of issues and decision by majority vote are not mentioned in the law.<sup>49</sup> If

42. Vice Premier Gu Mu announced on September 28, 1979 that the PRC would fully insure the legal rights of foreign partners of joint ventures and assured those partners that they would not get less return from investing in the PRC than in other countries, 276 U.S. EXPORT WEEKLY (BNA) C-1 (1979). At a later gathering of Chinese officials addressing the subject of joint ventures, prospective foreign partners were assured excellent terms in areas of tax, management, and administrative requirements, Wall St. J., Nov. 14, 1979, at 1, col. 5. Vice President Gu was quoted as offering investors better terms than any other country could offer them, *id.*

43. JVL, *supra* note 1, at art. 5 (where the Chinese partner contributes the right to use the situs as opposed to the partners using the situs under lease with the PRC).

44. *Id.*

45. *Id.* at art. 6. The contract and articles of association negotiated by the parties will stipulate the number and make-up of the board of directors, *id.*

46. *Id.*

47. At a New York Law Journal-sponsored seminar on "How to Do Business in China" held in Los Angeles on December 13-14, 1979, Allan B. Joseph of International Business Machines Corporation discussed a Chinese negotiating technique of introducing new and uninitiated negotiators during negotiating sessions, 287 U.S. EXPORT WEEKLY (BNA) C-5 (1979). Mr. Joseph added that a change in negotiators was a favorable sign in that any second team of negotiators is likely to be made up of the first team's superiors and that an agreement may be at hand, *id.*

48. JVL, *supra* note 1, at art. 6.

There exists support for the notion that the relationship between the participants in a business venture are more important than voting rights in a contract, C. KINDELBERGER, INTERNATIONAL ECONOMICS 404 (1963). An account of decision making in minority joint ventures (those in which no party has a majority vote and in which negotiating is prevalent), however, reveals significant delays and limitations in finalizing corporate plans, J. Kosnik, *supra* note 22, at 19.

49. Wall St. J., Aug. 31, 1979, at 6, col. 4.

disputes among the parties remain unsettled after consultation among the parties, the matter may be resolved by a Chinese arbitral body or by an arbitral body agreed upon by the parties rather than by judicial forum.<sup>50</sup>

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50. JVL, *supra* note 1 at art. 14.

The Foreign Trade Arbitration Commission (hereinafter cited as FTAC) was established in 1956 in the PRC to act as an arbitral panel for trade disputes involving corporations of the PRC. ATTITUDES, *supra* note 3, at 7. Though recourse to a judicial forum is possible, it is seldom practiced since the Chinese do not willingly subject themselves to the jurisdiction of courts, *id.* International trade disputes are normally settled by arbitration under the FTAC. For admiralty disputes, the Foreign Maritime Arbitration Commission (hereinafter cited as FMAC) functions in a similar manner, *id.*

The PRC has shown a willingness to agree to arbitration in a third neutral country and will generally agree to follow the rules of the country of arbitration, *id.* at 8. The Chinese may be careful to recommend a country, such as Sweden, which will use a greatest-contacts test in selecting which of the parties' substantive law to apply in arbitral deliberations, *id.*

In the event arbitration occurs in the PRC, the practice is to investigate facts, to have open hearings when evidence may be presented and to treat the parties equally, *id.* The FTAC, under the control of the China Council for the Promotion of International Trade (hereinafter cited as CCPIT) is made up of 21 members of which three are chosen to sit on each arbitral panel, *id.* at 5, 8, 13. By majority decision, the panel reaches its decision under three principles of operation: (1) independence and initiative, or self-reliance (whether the trading activities in question conformed to Chinese policy and law); (2) "equality and mutual benefit" with respect to each party (reflected in the terms and conditions of the contract); (3) "compliance with international practice and convention," *id.* at 3, 4, 8.

The FTAC is currently considering the New York International Convention on the Enforcement of Foreign Arbitral Awards for implementation in its arbitral decision process and has continued discussions with the American Arbitration Association concerning joint conciliation methods, *id.* at 4, 8, 9. See generally Holtzmann, *Resolving Disputes in U.S.-China Trade*, in LEGAL ASPECTS OF DOING BUSINESS WITH CHINA (H. Holtzman ed. 1976); PRICE, WATERHOUSE & CO., DOING BUSINESS IN THE PEOPLE'S REPUBLIC OF CHINA 14 (1979); Lubman, *Trade With The United States*, in LAW AND POLITICS IN CHINA'S FOREIGN TRADE, 220, 234-6, 242-3 (V. Li ed. 1977); Lubman, *Trade Between the United States and the PRC: Practice, Policy and Law*, 8 L. & POL'Y IN INT'L BUS. 44-47 (1976); Shaney, *Selected Legal Aspects of China's Conduct of Foreign Trade*, 11 INT'L LAW 652-655 (1977); *Legal Aspects of China's Foreign Practices and Procedures*, 12 J. INT'L L. & ECON. 122-123 (1977-78).

The Trade Agreement, *supra* note 4, contains a framework for dispute resolution between the countries which is broader than that described in the JVL. Only the Trade Agreement stipulates that arbitration may be conducted by an arbitral panel in the United States, Trade Agreement, *supra* note 4, at art. VIII, § 2; *Framework*, *supra* note 24, at 16. The JVL does not stipulate, as does the Trade Agreement, that the parties must first attempt friendly consultation and conciliation before arbitral deliberations begin. Trade Agreement, *supra* note 4, at art. VII, § 1; *Framework*, *supra* note 24, at 16. In addition, the JVL does not provide guidance over the panel's governing rules or provide for the timeliness of awards. Trade Agreement, *supra* note 4, at art. VIII, §§ 1, 2; *Framework*, *supra* note 24 at 16.

For insight into the interplay between the Trade Agreement and the JVL, see *Framework*, *supra* note 24, at 15-17. That study also reveals that the PRC is not a party to the United Nations Convention on the Recognition and Enforcement of Arbitral Awards, 21 U.S.T. 2517. T.I.A.S. No. 6997 (1970); *Framework*, *supra* note 24, at 16.

There are two major loss provisions in the JVL. The first concerns the foreign party.<sup>51</sup> Its contributed technology and equipment must be "truly advanced and appropriate to China's needs."<sup>52</sup> The foreign party would be responsible for any loss resulting from "deception through the international provision of outdated equipment or technology."<sup>53</sup> The second loss provision protects one party from the other party's breach of contract.<sup>54</sup> When a loss is incurred, the board of directors or arbitral panel decides the degree of, cause of, and responsibility for the loss.<sup>55</sup>

The JVL set priorities for the sources of insurance,<sup>56</sup> raw and semi-processed materials,<sup>57</sup> and foreign exchange regulations<sup>58</sup> but generally leaves open the selection of banks<sup>59</sup> and markets.<sup>60</sup> In-

51. JVL, *supra* note 1, at art. 5.

52. *Id.*

53. *Id.*

54. *Id.* at art. 13.

55. *Id.* at art. 14.

56. *Id.* at art. 8.

57. *Id.* at art. 9.

58. *Id.* at arts. 8, 19, 11. Although the currencies to be used by the joint venture for purposes of remitting registered capital contributions, profits, or compensation may be stipulated in the contract, any foreign exchange transactions will be administered under the rules of the Foreign Exchange Regulations of the PRC, *id.*

The currency of the PRC is the *Rennminbi* (RMB), or "the People's currency," ATTITUDES, *supra* note 3, at B-15, B-44; PRICE, WATERHOUSE & CO., DOING BUSINESS IN THE PEOPLE'S REPUBLIC OF CHINA, 6, 7 (1979). The  *yuan* (Y) is the basic unit which is divided into 10 *jiao* or 100 *fen*, or cents, *id.* Thus,

1 *yuan* (Y) = 100 *fen*

1 *Jiao* = 10 *fen*

The RMB, though considered highly stable, is not an internationally convertible currency, *id.* It is not traded on international exchange markets, but is used solely in foreign exchange transactions as a unit of account, *id.* Its exchange value is determined by the Bank of China and changes from time to time in response to international monetary conditions. Bid and offer rates for the RMB against western currencies are posted by the Bank of China *id.* During 1978, for example, the offering price of the RMB fluctuated between 57.6 and 63.6 U.S. cents, *id.* 1979 prices remained stable, *id.* For a look at the RMB exchange rate for a number of currencies from 1977 to early 1979, see PRICE, WATERHOUSE & CO., DOING BUSINESS IN THE PEOPLE'S REPUBLIC OF CHINA 7 (1979).

It is possible to purchase RMB denominated contracts to purchase RMBs forward; however, its relative stability against other currencies, the high cost of forward RMBs (30% on a six-month contract) and the frequency of other currency denominated contracts reduce the incentive for such contracts, *id.* See also Deamer, *Bank of China in a New Financial Role*, 1 E. ASIAN EXEC. REP. No. 1, 18 (1979) and note 117 *infra*.

59. JVL, *supra* note 1, at arts. 8, 19, 11. For an account of the recent developments in the PRC banking system, see ATTITUDES, *supra* note 3, at 9-10, B-9; Deamer, *supra* note 58, at 3, 17-18; Deamer, *Understanding the Bank of China's Letter of Credit Practices*, 1 E. ASIAN EXEC. REP. No. 3, 3, 19-21 (1979); Lubman, *Trade Between the United States and the People's Republic of China: Practice, Policy and Law*, *supra* note 6, at 26.

60. JVL, *supra* note 1, at art. 9.

insurance for the joint venture is to be provided only by Chinese insurance companies.<sup>61</sup> Raw and semi-processed resources and auxiliary equipment<sup>62</sup> should originate, if available, from Chinese sources.<sup>63</sup> These priorities create an obligation in favor of existing or future Chinese suppliers of materials and intermediate goods without regard for competitive prices. The ripple effect throughout the Chinese economy of "Buy Chinese" may have as significant a bearing on board of directors' decisions as maximizing returns.<sup>64</sup>

The JVL declares that joint ventures shall be implemented through the contracts<sup>65</sup> under Chinese law and rules<sup>66</sup> and shall be subject to authorization by the Chinese government.<sup>67</sup> The history of contractual relationships between the PRC and foreign entities reveals a preference by the Chinese to memorialize agreements under moral rather than legal concepts.<sup>68</sup> Therefore, in the

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61. *Id.* at art. 8.

The PRC has placed 300 agents in over 100 foreign ports and cities to provide insurance coverage for a variety of trade and transportation arrangements, *Syracuse Herald J.*, Dec. 9, 1979 at 15. Song Guohua, representing the People's Insurance Company of China, stated recently that Chinese insurance rates and compensation payments would be adjusted to international standards and that damage claims would be promptly paid, *id.* See also ATTITUDES, *supra* note 3, at B-10, B-16; DOING BUSINESS IN THE PEOPLE'S REPUBLIC OF CHINA, *supra* note 58, at 15; Shaney, *supra* 16, at 648; Hsiao, *Chinese Trade Contracts*, in LEGAL ASPECTS OF DOING BUSINESS WITH CHINA, *supra* note 3, at 158-164.

62. JVL, *supra* note 1, at art. 9.

63. *Id.*

64. The utilization of Chinese raw and semi-processed goods and the encouragement to seek foreign markets for the finished goods are in keeping with a plan to maximize the foreign exchange liquidity position of the PRC, *Framework*, *supra* note 24, at 15.

65. JVL, *supra* note 1, at art. 9.

66. *Id.* at art. 2.

67. *Id.* at art. 1.

68. There is an old Chinese proverb about moral concepts ruling men and laws needed to rule barbarians. Given the absence of a formalized commercial code in the PRC (see ATTITUDES, *supra* note 3, at 11; *Legal Aspects of China's Foreign Trade Practice and Procedure*, *supra* note 7, at 133), the language of the contract itself has been the key to defining legal relationships between the PRC and its trading partners, *id.* See also Lubman, *supra* note 6, at 4. Normally in a contract involving the PRC, there was no mention of a legal system governing performance or disputes, Shaney, *supra* note 16, at 647; in choice of law matters it was only a guess which law was to be used, *id.* at 652.

A paradox arises, however, in matters of misunderstanding of or dispute over the language of the contract. While the contract is of the utmost importance in defining the parties' legal rights and obligations, the Chinese prefer to rely upon the underlying trading relationship of the parties, or "customary practices," and their mutual good faith and reasonableness should a problem over interpreting the contract language arise, *Legal Aspects of China's Foreign Trade Practices and Procedures*, *supra* note 7, at 114; ATTITUDES, *supra* note 3, at 11; Li, *Trade With China: A Cautionary Prospectus*, in CHINA'S

absence of a more formalistic legal system in the PRC, the foreign joint venture partner's literal dependence on the JVL or its supporting or contemplated<sup>69</sup> law and regulations in areas such as patents,<sup>70</sup> trademarks,<sup>71</sup> copyrights,<sup>72</sup> taxation,<sup>73</sup> employee rela-

TRADE WITH THE WEST, *supra* note 12, at 219-220. It has been the practice of the Chinese to use brief standardized contracts which employ general terms, ATTITUDES, *supra* note 3, at 11; Theroux, *supra* note 16, at 123. This further implies that customary practices with which the foreign businessman may be unfamiliar are significantly infused in the trading relationship. For an account of the methods employed to insure a detailed contract and avoid subsequent misunderstandings with the Chinese, see Reghizzi, *Legal Aspects of Trade With China-The Italian Experience*, 9 HARV. INT'L L.J. 85 (1968); Reghizzi, *Trade With Italy, Law and Politics in China's Foreign Trade*, *supra* note 3, at 169; Tung-pi *Legal Aspects of Canadian Trade With the People's Republic of China*, 38 L. & CONTEMP. PROB. 201, 216 (1973).

69. In addition to his statement that the PRC will fully insure the legal rights of foreign partners in joint ventures, *supra* note 42, Vice Premier Gu has assured prospective investors that the Chinese are now working on relevant regulations to create favorable conditions in order to bring technical expertise and management experience "into full play," *id.* Peng Zhen, Chairman of the Legal Commission of the Standing Committee of the National People's Congress, admitted that the JVL was not comprehensive, Wall St. J., June 27, 1979 at 15, col. 1. Mr. Peng added that special regulations concerning the application of the JVL are to be worked out and that related economic legislation would be made and enforced "from time to time," *id.*

70. For a review of the current state of the law concerning the protection of industrial and intellectual property in the PRC, see Tao-Tai and Haun, *Law of the Peoples's Republic of China on Industrial and Intellectual Property*, 38 L. & CONTEMP. PROB. 274-291 (1973); ATTITUDES, *supra* note 3, at 4-5, B-18, B-19; DOING BUSINESS IN THE PEOPLE'S REPUBLIC OF CHINA, *supra* note 25, at 16; Theroux, *supra* note 16 at 126-7. See generally LI, LAW AND POLITICS IN CHINA'S FOREIGN TRADE, *supra* note 7.

Generally, there exists no patent law in the PRC; however, the Chinese have been willing in the past to give contractual assurances of limiting the use of the foreign party's technology within the PRC and of prohibiting the transfer of that technology to other countries.

In contrast, the Trade Agreement offers considerable assurance to the governments of the United States and the PRC that the use of patents, trademarks, and copyrights is to be protected, Trade Agreement, *supra* note 4, at art. VI.

71. *Id.* Generally, a foreign entity interested in registering a trademark in the PRC must apply through the CCPIT which will act on its behalf before the Trademark Registration Agency. Marks are valid for 19 years and are renewable for subsequent 10 year periods.

72. *Id.* Generally, the PRC is neither a member of the Universal Copyright Convention or the Berne Copyright Convention.

73. Chinese tax authorities are currently studying tax matters related to joint ventures, ATTITUDES, *supra* note 3, at 20. It is the law, however, that a joint venture is subject to an income tax on its gross profits "pursuant to the tax laws of the People's Republic of China . . .," JVL, *supra* note 1, at art. 7. Tax deductions or incentives exist for reserve funds, bonuses and welfare funds established for workers and staff members as well as for expansion funds and reinvested profits, *id.* The use of up-to-date technology in the joint venture may result in a reduction of or exemption from income taxes for the first two to three profit years, *id.*

There is currently a 3 percent sales tax in the PRC, *id.* In addition, an Industrial and Commercial Consolidated Tax, similar to a turnover tax, may be incurred at certain stages



tions,<sup>74</sup> and auditing and accounting methods<sup>75</sup> may appear at first premature. Further uncertainties have arisen, such as the legal implications of the sale of a partner's interest in a joint venture, or the "limited liability"<sup>76</sup> status of the joint venture. Such uncertainties could conceivably be resolved at the contract negotiation stage.

### III. THE TAX ATMOSPHERE SURROUNDING CHINESE JOINT VENTURES

#### A. Pre-1980

A tax law contemplated in Article 7 of the JVL was expected to provide guidelines for questions regarding joint ventures in the areas of the measure, distribution, and repatriation of profits for tax purposes among partners.<sup>77</sup> Gross and net profits, apparent-

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of production which would present a problem for United States firms, for example, which cannot utilize a tax credit for taxes previously paid, *id.*; *Framework*, *supra* note 24, at 15, and notes 87-91 and accompanying text.

74. In a country where worker efficiency is a problem and where there exists a tremendous impulse on the part of young people in the PRC to gain attractive wages by moving to Hong Kong, employment costs for a joint venture are considered to be a big problem. Jermoe Cohen, Director of the Harvard Law School's East Asian Legal Studies Program, in a speech at the New York Law Journal seminar on "How to Do Business in China" held in Los Angeles on December 13-14, 1979, *in part reprinted in* 187 U.S. EXPORT WEEKLY (BNA) C-4 (1979). It is estimated that wages under the JVL are expected to be 70 to 80 percent of those paid in Hong Kong, *id.*

According to the JVL, both board decisions and provisions negotiated in the contract will govern employment relations, JVL, *supra* note 1, at art. 6. *See also Framework*, *supra* note 25, at 15. In light of the historical policy of job security in the PRC, Mr. Rong of CITIC was asked whether Chinese workers could be regularly hired and fired for legitimate business reasons. Wall St. J., Nov. 124, 1979, at 1. He responded that the PRC wants to learn management techniques from foreign investors, and all parties would be involved in making those decisions, *id.*

The quote of Vice Premier Li, appearing in note 17 *supra*, signifies the PRC's management trend toward western work incentives.

75. Beginning in early 1980, the Chinese Foreign Ministry's Accounting and Finance Societies will begin a training program for its members under agreement with Coopers and Lybrand (International), particularly to accommodate joint venture activities in the PRC, 281 U.S. EXPORT WEEKLY (BNA) C-1-C-2 (1979).

The only reference to auditors in the JVL is found in article 6 which states that the duties and remuneration of those positions will be determined by decision of the board of directors. For a further discussion, *see* note 117 and accompanying text.

76. JVL, *supra* note 1, at art. 4.

77. *See Note, Foreign Investment in the People's Republic of China: Compensation Trade, Joint Ventures, Industrial Property Protection, and Dispute Settlement*, 10 GA. J. INT'L & COMP. L. 233, 249-54 (1980) (hereinafter cited as *Foreign Investment*); *Note, Joint Ventures in the People's Republic of China*, 14 J. INT'L L. & ECON. 133, 149 (1979) (hereinafter cited as *Ventures*).

ly were to be determined after deductions for reserve funds, worker bonuses, welfare funds, and expansion funds.<sup>78</sup> Exemptions and deductions were anticipated where technology was advanced and up-to-date, yet the time frame for such preferences was uncertain beyond the initial year of the joint venture's profitability.<sup>79</sup> It was unclear whether the preferences were to be taken before or after the allotment for taxes. In addition, net profits and other funds acquired by the joint venture, as in liquidation, were to be remitted through the Bank of China, which was to apply as yet unenacted foreign exchange regulations.<sup>80</sup> Through the life of the joint venture "encouragements" were anticipated which would allow the Bank of China to retain deposits of foreign exchange, and would permit the deduction from income taxes of interest earned from deposits of foreign currency in the Bank of China.<sup>81</sup>

Absent the enactment of a joint venture tax law, potential foreign investors often anticipated a western-style pattern of taxation.<sup>82</sup> Support for this approach arose at a time when, at the invitation of the PRC, a number of U.S. tax experts traveled to Beijing to discuss joint venture taxation.<sup>83</sup>

The inference among high ranking PRC officials involved in joint venture tax matters was that the country's current tax structure would remain in force, yet joint ventures would receive singular treatment.<sup>84</sup> Specialized tax treatment of joint ventures is not unknown among non-Western socialist states. Scholarly examination of the tax laws in Romania,<sup>85</sup> for example, reveals a reserve fund tax on joint ventures profits earned there in the amount of approximately 5 percent, which is deductible against gross income up to an amount where the aggregate tax paid equals 25 percent of total capital invested in the joint venture.

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78. See Pomp and Surrey, *The Tax Structure of the People's Republic of China*, 20 VA. J. INT'L L. 1, 10 (1979) (hereinafter cited as Pomp and Surrey); *Foreign Investment*, *supra* note 77; and *Ventures*, *supra* note 77.

79. Pomp and Surrey, *supra* note 78, at 11.

80. *Foreign Investment*, *supra* note 77, at 251.

81. *Id.*

82. *Id.*

83. *Id.*

84. See Klingenberg and Pattison, *Joint Ventures in the People's Republic of China: The New Legal Environment*, 19 VA. J. INT'L L. 807, 828 (1979) (hereinafter cited as Klingenberg and Pattison).

85. Klingenberg and Pattison, *supra* note 84; *Ventures*, *supra* note 77, at 139. See generally Scriven, *Joint Venture Legislation in Eastern Europe: A Practical Guide*, 21 HARV. INT'L L.J. 633 (1980).

Contributions from the venture are required to support a social insurance fund for all employees. A generalized 30 percent tax exists on net profits, and incentives in the form of reduction of that rate are permitted where profits are reinvested. A tax holiday is allowed during the first year of the Romanian joint venture's profitability. As another comparative example, a 40 percent joint venture tax on net profits exists under Hungarian law.<sup>86</sup> Where the Hungarian Minister of Finance determines that the venture is of particular benefit to the state, however, the tax may be reduced.

Two major corporate tax rate structures were in force in the PRC before the JVTL and are thought by some to apply to joint ventures as well. The Industrial and Commercial Consolidated Tax acts as a turnover tax and is the equivalent of a sales tax at each production stage.<sup>87</sup> This tax is levied without regard to previous taxes paid and has ranged historically from 1.5 percent to 69 percent depending upon the nature of the product.<sup>88</sup> The Industrial and Commercial Income Tax applies to all non-PRC-controlled or partially controlled enterprises functioning within the PRC.<sup>89</sup> This second tax is based on gross receipts after the above described consolidated tax is levied and after deductions for administrative and production costs. It is characterized as a progressive tax ranging from 5.75 percent to 34.5 percent.<sup>90</sup> There exists, in addition, a surtax which may vary from 10 to 100 percent of the income tax due. As of this writing, a 60 percent uniform surtax is imposed.<sup>91</sup>

The steps leading to the JVTL and JVTR involved an overall four-year drafting effort by the PRC to initiate a comprehensive tax code.<sup>92</sup> The degree and scope of the tax and tax preferences or incentives were cause for concern among tax experts. Precedent for waiving or diminishing the taxes of agricultural enterprises or fledgling industries appeared encouraging.<sup>93</sup> The Chinese,

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86. *Id.*

87. DOING BUSINESS WITH THE PEOPLE'S REPUBLIC OF CHINA, *supra* note 4, at 17; Pomp and Surrey, *supra* note 78, at 12; Torber, *China's Joint Venture Law: A Preliminary Analysis*, 12 VAND. J. TRANSNAT'L L. 819, 867 (1979) (hereinafter cited as Torbert).

88. *Id.*

89. DOING BUSINESS WITH THE PEOPLE'S REPUBLIC OF CHINA, *supra* note 4, at 17; Pomp and Surrey, *supra* note 78, at 5.

90. *Id.*

91. *Id.*

92. Klingenberg and Pattison, *supra* note 84, at 828.

93. *Id.* In light of Chinese legislation entitled the Provisional Statute on Private Enterprises, additional tax incentives may be awarded to companies involved in ac-

however, were emphasizing the relatively lower costs of their local labor, the availability of raw materials, political stability, and the size of the domestic market as benefits to be weighed against tax incentives.<sup>94</sup> As a result, it was recommended that tax rates and other benefits which were negotiated with the PRC Foreign Investment Commission,<sup>95</sup> and which were potentially beyond the range of Article 7 of the JVL, be incorporated into the language of the agreement and be grandfathered in notwithstanding future tax legislation.<sup>96</sup>

### B. *The JVTL and JVTR*

On September 10, 1980, the JVTL and the JVTR were enacted. Law scholars and students expertly examined the law and regulations with a resulting discovery of ambiguity in areas such as discretionary tax deductions, refunds and reductions, the foreign tax credit, incentives for reinvestment versus savings, and tax jurisdiction.<sup>97</sup> Further concern was expressed over accounting principles and formulae for calculating costs.<sup>98</sup> The mechanics of the law and regulations are almost deceptively straightforward in terms of a benchmark tax rate. In light of the scope of the law undertaken in a relatively short period of time and in such a context as the legal system of the PRC, it should not be surprising that negotiation is still incorporated with the new joint venture tax framework.<sup>99</sup> It would be overly zealous to anticipate voiding entirely the case-by-case business approach with which the PRC

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tivities which either introduce a significant new invention or are directed towards the country's needs, Torbert, *supra* note 87, at 868.

94. Pomp and Surrey, *supra* note 78, at 12.

95. See Torbert, *supra* note 87, at 867.

96. Cohen, *supra* note 74 at C-4; Klingenberg and Pattison, *supra* note 84; Pomp and Surrey, *supra* note 78, at 22; Theroux, *Transfer of Technology to China: New Laws and Old Problems*, 14 J. INT'L L. & ECON. 185, 250 (1980).

97. See generally Theroux, *supra* note 96; 22 HARV. INT'L L.J. 234 (1981); *People's Republic of China-Rules To Implement Income Tax Law For Joint Ventures Issued*, 3 E. ASIAN EXEC. REP. No. 2, 6 (1981).

98. Such concern has been expressed notwithstanding the presence of Articles 23-6 of the JVTR, *supra* note 21. See Theroux, *supra* note 96 at 250.

99. Negotiations are anticipated under the JVTL, *supra* note 20, for example, under articles 2 (deductions of costs, expenses, and losses), 3 (income tax rates for joint ventures exploiting petroleum, natural gas and other resources), 5 (tax exemptions for long-term, low profit or geographically remote ventures or for investment in underdeveloped industries), 6 (reinvested tax refunds), and 15 (tax disputes) and under JVTR, *supra* note 21, under articles 3 (reduction in local taxes), 13 (accelerated depreciation), 17 (amortization), 18 (computing inventory), 19 (amount of quarterly tax payments), and 24 (method of accounting).

feels comfortable, particularly under this relatively new development in law and business. Risk is an obvious component of investment, and it is apparent that enterprises which have taken the joint venture initiative with the PRC have already been received with favor for their leadership role.<sup>100</sup>

Joint ventures are generally taxed on net income at an overall annual rate of 33 percent, made up of a combination of a 30 percent standardized or flat rate and a local surtax amounting to 10 percent of the already incurred income tax.<sup>101</sup> Tax rates for joint ventures exploiting petroleum, natural gas, and other resources, however, are negotiated separately.<sup>102</sup> In the event the foreign participant withdraws all or part of his share of the profits, a 10 percent income tax is levied on the withdrawn amount.<sup>103</sup>

Tax incentives exist for long term,<sup>104</sup> low profit,<sup>105</sup> or geographically remote projects.<sup>106</sup> Tax credits,<sup>107</sup> reinvestment of profits,<sup>108</sup> and loss carry-over forwards<sup>109</sup> may also work to the advantage of the foreign investor. Formulae for or descriptions of taxable income,<sup>110</sup> depreciation and amortization,<sup>111</sup> fixed<sup>112</sup> and intangible<sup>113</sup> assets along with dispute resolutions<sup>114</sup> and administrative matters<sup>115</sup> are described within the new law and regulations. Perhaps these items, or their greater clarification where needed or desired, may be incorporated or grandfathered into the joint venture's activities either under pre-arranged terms of

100. Theroux, *supra* note 96, at 249.

101. JVTL, *supra* note 20, at art. 3; JVTR, *supra* note 21, at arts. 8, 9.

102. JVTL, *supra* note 20, at art. 3; JVTR, *supra* note 21, at art. 2.

103. JVTL, *supra* note 20, at art. 4; JVTR, *supra* note 21, at art. 4.

104. JVTL, *supra* note 20, at arts. 5, 6.

105. *Id.* at art. 5.

106. *Id.*

107. *Id.* at art. 16; JVTR, *supra* note 21, at art. 3s. See also Edwards, Legal and Economic Considerations on Doing Business in the People's Republic of China 24(a) (March 7, 1981) (unpublished thesis retained by author in Winston-Salem, North Carolina) which cites *Bank of America v. United States*, 459 F. 2d 513 (Ct. Cl., 1972) *cert. den.* 409 U.S. 949 (1972), and an interesting discussion comparing tax credits with respect to taxes on gains or profits as opposed to taxes on gross receipts.

108. JVTL, *supra* note 20, at art. 6.

109. *Id.* at art. 33.

110. JVTR, *supra* note 21, at arts. 8, 9.

111. *Id.* at arts. 19, 12, 13, 17.

112. *Id.* at arts. 11, 12, 14.

113. *Id.* at art. 16.

114. JVTL, *supra* note 20, at art. 15; JVTR, *supra* note 21, at art. 31.

115. JVTR, *supra* note 21, at arts. 19, 20, 21.



the agreement or under agreements between the governments of the PRC and of the foreigner.<sup>116</sup>

With regard to the valuation and holding of currencies, the Provisional Regulations For Foreign Exchange Control<sup>117</sup> were recently enacted in an effort to standardize and centralize currency exchange matters.<sup>118</sup> Chapter 5 of these regulations applies to foreign joint ventures and requires them to deposit all foreign exchange receipts in the Bank of China and to settle their accounts in *renminbi* unless otherwise approved. Remitting net profits and earnings abroad involves a procedure whereby the joint venture debits its foreign exchange deposit account by the amount it withdraws.

#### IV. CONCLUSION

The JVL has been viewed in an evolutionary manner in that supporting tax and other laws and regulations would be formulated as joint ventures developed. The JVL itself represents a stepping stone to the eventual contractual relationship between the foreign investor and the corresponding PRC agency.<sup>119</sup>

The Chinese have been characterized as being deliberate in business dealings with foreign entities.<sup>120</sup> The number of joint ven-

116. JVTL, *supra* note 20, at art. 16; JVTR, *supra* note 21, at art. 32.

117. Provisional Regulations For Foreign Exchange Control (effective March 1, 1981), *unofficial translation reprinted in* 3 E. ASIAN EXEC. REP. No. 2, 21 (1981) with a discussion by Claudia J. Gilman appearing in the same publication at page 3.

118. Provisional Regulations For Foreign Exchange Control, *supra* note 117, at arts. 22-6.

119. A joint venture agreement under the JVL has been characterized as an intermediate document covering the basic elements of a proposed joint venture which the parties agree to before an actual contract is initiated, Cohen, *supra* note 74. The contract itself fills out the "skeleton" created by the joint venture agreement, *id.* The prospective foreign partner must be mindful, in addition, of other preliminary documents such as letters of understanding, tentative agreements, protocols, or accords which may be required before or after the joint venture agreement is signed. *Id.*; Wall St. J., Oct. 11, 1979, at 6, col. 1; *id.* Oct. 5, 1979, at 20, col. 1.

The JVL itself has been labeled a "very general" statute serving primarily to protect resources invested by, and profits due to, foreign partners in conformity with contracts and agreements approved by the Chinese government as well as the foreign partner's other rights and interests, ATTITUDES, *supra* note 3, at 14.

120. For historical accounts of the slow and deliberate pace of the Chinese to business relationships, see generally Lubman, *Trade Between the United States and the People's Republic of China: Practice, Policy, and Law*, *supra* note 6; Shaney, *Selected Legal Aspects of China's Conduct of Foreign Trade*, *supra* note 16; *Legal Aspects of China's Foreign Trade Practices and Procedures*, *supra* note 7; Feng-hwa, *supra* note 3, at 1-12; Stahnke, *The Political Context of Sino-West German Trade*, in CHINA'S TRADE WITH THE WEST, *supra*

tures in operation reflects this deliberateness. Perhaps the lack of a detailed understanding of foreign tax and business practices,<sup>121</sup> the problem of how to absorb a significant volume of business or new technology, or the existence of alternative methods of foreign direct investment<sup>122</sup> have contributed to that number. Foreign business interests may share concerns over the absence of fully supporting laws and regulations contemplated by the JVL, political stability,<sup>123</sup> or the unrevealed costs of opportunity<sup>124</sup> in initiating a business relationship with a nation characterized as rural.

The commitment by Chinese leaders to joint ventures is clear.<sup>125</sup> In the midst of a revitalized, but recently somewhat tempered, interest on the part of the PRC to modernize by attracting foreign capital and technology,<sup>126</sup> the JVL represents a significant opportunity for the outside investor to initiate an early business and personal relationship with the PRC. Whether or not there exists a retrenchment of the Four Modernizations program whereby the PRC announced a 13 percent cutback in its 1981 budget,<sup>127</sup> the particular attraction of doing business in the form of

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note 12, at 35-87; DOING BUSINESS WITH THE PEOPLE'S REPUBLIC OF CHINA, *supra* note 4, at 11-12, 43-57; *Chinese Business Customs and Behavior*, in LEGAL ASPECTS OF DOING BUSINESS WITH CHINA, *supra* note 3, at 73-76; HOW TO APPROACH THE CHINESE MARKET 119-132 (1972); ATTITUDES, *supra* note 3, at 11. For most recent indications, see generally Wall St. J., Oct. 2, 1979, at 16, col. 3; *id.*, Oct. 17, 1979, at 16, col. 3.

121. C.L. Haslam, General Counsel of the United States Department of Commerce, has stated that the PRC lacks a detailed understanding of business practices and government trade policies of the United States, Wall St. J., May 15, 1979, at 8, col. 2. It was his opinion that Chinese leaders found such practices and policies to be "baffling, complex, and too legalistic," *id.*

122. For a description of the specific alternative foreign investment schemes in the PRC, see ATTITUDES, *supra* note 3, at B-14; DOING BUSINESS WITH THE PEOPLE'S REPUBLIC OF CHINA, *supra* note 4, at 10-11.

123. See ATTITUDES, *supra* note 3, at 25-26. An estimate of at least five years of stable politics in the PRC was offered by Richard H. Solomon, Director of the Research Program of International Security Policy of the Rand Corporation, 287 U.S. EXPORT WEEKLY (BNA) C-1 (1979). He claimed that it was possible for a major political change in the country over the long term given the PRC's past record, however, he cited the importance in the PRC of doing business responsibly, *id.*

124. Due to overlooked "costs of the opportunity" and political and economic risks involved in business deals with the PRC, it is one author's view that the outlook for such investment is dim in areas other than the purchasing of Chinese exports and compensating trade agreements in labor intensive or extracting industries, ATTITUDES, *supra* note 3, at 28.

125. Theroux, *supra* note 96, at 249.

126. TIME, March 16, 1981, at 68.

127. *Id.*

a joint venture remains. Large budget deficits, inflation and increased foreign debt have recently caused the PRC to renege on portions of multi-million dollar contracts.<sup>128</sup> The country's foreign trade, however, continues to grow notwithstanding the loss of some of its business credibility.<sup>129</sup>

As a result, the Chinese appear to be keenly interested in joint venture projects which offer the advantages of avoiding financing and currency problems, while promoting technological resources, business relationships, and a modernization plan. Despite the range of new laws and regulations, the foreign investor must anticipate the negotiation process which is interwoven into the JVL, JVTL, and the JVTR. Chinese joint ventures represent a significant and long-term business opportunity. They beckon the overly cautious foreigner to even consider a "quick results" investment, thereby initiating a profitable opportunity for the foreigner and the PRC to become accustomed to one another's business and personal mannerisms. Tax incentives under law and supplemented under agreement should permit even the pessimist concerned with the lack of normal free-market forces<sup>130</sup> some guarded optimism over the potential returns from Chinese joint venture business dealings.

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128. *Id.*

129. *Id.*

130. Theroux, *supra* note 96, at 249.