A study of the present income tax law in China

Chou, Hung-sheng

Boston University

http://hdl.handle.net/2144/16657

Boston University
A STUDY OF THE PRESENT INCOME TAX LAW IN CHINA

by

Hung-sheng Chou
(A.B. St. John's University 1945)

submitted in partial fulfillment of the requirements for the degree of

MASTER OF BUSINESS ADMINISTRATION
TABLE OF CONTENTS

PART I
INTRODUCTION

Chapter                                                                 Page
1. DEVELOPMENT AND NATURE OF INCOME TAX                   . . . . . 3
2. HISTORICAL DEVELOPMENT OF THE INCOME TAX IN CHINA       . 5
3. ASPECTS OF THE PRESENT INCOME TAX LAW WHICH ARE        IMPROVEMENTS OVER THE 1936 REGULATIONS . . . . . 8

Scope; Rate; Rental Income; Income Earned by Government Enterprises; Exemptions; Over-all Income Tax; Other Changes.

PART II
THE PRESENT INCOME TAX LAW SINCE APRIL 16, 1946

4. GENERAL PROVISIONS                                       . . . . . . . . . . . . . . . 13

Scope of the Income Tax Law; Method of Computation of Income Tax; Investigation and Collection; Fine.

5. BUSINESS INCOME                                          . . . . . . . . . . . . . . . 17

A. Corporation

Determine the amount of capital; Determine the amount of net income; Find the ratio of net income to the capital; Find tax rate for that ratio in the table; Determine the amount of tax liability; Cooperative enterprise.

B. Partnership and Single Proprietorship

Rate; Registration; Other Comments; Examples.
### Chapter 6: Compensation for Service

A. Professional Class

- Computation; Deductions; Rate; Declaration; Investigation.

B. Salaried Class

- Computation; Exemptions; Rate; Some Special Cases; Declaration.

### Chapter 7: Rent

- Classes of Rental Income; Computation; Deductions; Exemptions; Rate; Other Comments; Declaration and Collection.

### Chapter 8: Interest and Dividend

- Deposit Interest; Dividends from stocks; Bond Interest; Cash surrender value of life insurance policies over the amount of premiums paid; Declaration and Collection; Other Comments.

### Chapter 9: Other Income

- Definition; Rate; Declaration; Example.

### Chapter 10: Over-All Income Tax

- Definition; Exemptions; Rate; Example; Price Index Relief.

---

**PART III**

**GENERAL DISCUSSION AND CONCLUSION**

### Chapter 11: Some Accounting Problems Involved in the Computation of Income Tax
Chapter 11 (Cont'd)

Valuation of property; Determination of the basis for computation of net income; Determination of a fiscal year; Distinction between capital expenditure and revenue expenditure.

12. COMPARISON OF SOME ASPECTS OF THE INCOME TAX IN CHINA AND THE FEDERAL INCOME TAX OF THE UNITED STATES  84

Scope; System; Methods of computation, investigation, and collection; Deductions; Exemptions; Partnership and single proprietorship; Capital gain and loss; Miscellanea.

13. DISCUSSION ON THE INCOME TAX IN CHINA  88

Inflation; Imperfection of accounting system; Low efficiency of administration.

14. FUTURE OF INCOME TAX IN CHINA  93

BIBLIOGRAPHY  97

A. Books.

B. Magazine Articles.

C. Pamphlets.
## LIST OF TABLES

<table>
<thead>
<tr>
<th>Table</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. MINIMUM USEFUL LIFE FOR COMPUTATION OF DEPRECIATION</td>
<td>28</td>
</tr>
<tr>
<td>II. TAX RATES FOR CORPORATIONS</td>
<td>34</td>
</tr>
<tr>
<td>III. TAX RATES FOR BUSINESS ENTERPRISES OTHER THAN CORPORATION</td>
<td>36</td>
</tr>
<tr>
<td>IV. TAX RATES FOR PROFESSIONAL CLASS</td>
<td>43</td>
</tr>
<tr>
<td>V. TAX RATES FOR SALARIED CLASS</td>
<td>46</td>
</tr>
<tr>
<td>VI. TAX RATES FOR RENTAL INCOME</td>
<td>54</td>
</tr>
<tr>
<td>VII. TAX RATES FOR OTHER INCOME</td>
<td>67</td>
</tr>
<tr>
<td>VIII. OVER-ALL INCOME TAX RATES</td>
<td>71</td>
</tr>
</tbody>
</table>
PART I

INTRODUCTION
INTRODUCTION

The purpose of this monograph is to study the income tax system which China has been employing for the past three years. This system will be compared in some respects to the older income tax laws of China as well as to the Federal Income Tax Law of the United States. Some accounting problems involved in the computation of income tax in China will also be investigated. Finally, the general picture of the income tax in China will be studied, including its administration, its future, and the effects of inflation upon it.

Before the income tax law of China is studied, however, the nature of income tax in general and its historical development in China will be discussed.
Chapter 1
DEVELOPMENT AND NATURE OF INCOME TAX

Throughout history, systems of taxation have progressed with the development of social concepts. The earliest known taxes were those levied directly upon specific persons. They include poll taxes, land taxes, and property taxes. As society progressed, however, the need for more revenue brought about the use of indirect taxes which were imposed upon the goods consumed by the people rather than individuals. Examples of indirect taxes are consumption taxes, salt taxes, and custom duties, which were placed upon the groups of people who used those specific products.

As time went on, there was need for still more revenue than that which could be obtained by the two methods of taxation just described. More public functions developed - such as, national defense and the maintenance of law and order. These functions could not possibly be performed by individuals but should be performed by the government with the cooperation of the individuals. The need for more and more money to finance these projects has brought about the income tax as the primary source of public income by most of the progressive countries in the world.

The income tax has been found to embody all of the characteristics of a good tax system. The ideal tax not only
brings a large revenue to the government but also is fair to all the people. It is permanent and reliable as well as elastic enough to fluctuate with the variation in national expense. The income tax embodies all of these ideals. It is fair to the people because the amount of tax varies directly with the ability to pay. It is levied upon the surplus income of individuals - that is, the difference between total income and minimum allowance for cost of living. Moreover, all kinds of income are taxable, thus making the law fairer to all the people. The revenue from the income tax is reliable and permanent simply because national income is always available for taxation. Further advantages of the reliability and permanence of the income tax are the ease with which a public budget can be prepared and the tax burden distributed to the people. Finally, the income tax is elastic since the rates can always be changed to conform to the demand for public expenditure.

Chapter 2

HISTORICAL DEVELOPMENT OF THE INCOME TAX IN CHINA

The history of income tax in China is comparatively young, the first act having been initiated in 1910 at the end of the Tsing Dynasty. Before this act was passed through the parliament, however, the Tsing Dynasty was overthrown by the Revolution which resulted in the founding of the Republic of China in 1911. It was not until the third year of the new Republic that the government at Peiking realized the need of an income tax to produce the necessary public revenue. On June 11, 1914, twenty seven income tax regulations were passed through the Legislative Yuan. Enforcement of these rules was initiated in 1915. The scope of the act was not very broad covering only business and interest income. The tax rate for business income was two percent levied on the net business income, while the interest income, except that from government bonds, was subject to a one and a half percent tax. The purpose of such low rates was to obtain the maximum revenue possible without producing too much resentment in the people who were sud-

denly presented with this brand new method of extracting revenue.

During the years that followed, there was not only a lack of progress in the development of income tax but also a handicap to the enforcement of the law by the continued civil wars lasting until 1928, the seventeenth year of the Republic. At that time the united government was established at Nanking, the present Capital of China. This brought revisions of certain income tax rules, but these had a very narrow scope. Only the salaries of the government employees were subject to the income tax. Fifty dollars out of the monthly salary of each employee was exempted from tax, the second fifty was subject to a one percent tax, and each hundred dollars thereafter was subject to an additional one percent tax up to a maximum of eight percent. The revenue from the income tax was used wholly for pensioning the members of the Kuo Ming Tang, an exclusive political party whose members occupied the higher public offices.

In 1935, the twenty fourth year of the Republic, the first formal act of income tax regulations was voted by the Ministry of Finance in an effort to increase the public revenue. This act was passed by the Legislative Yuan on July 9, 1935. It consisted of thirty-one rules with explanations and had a broader scope than any previous incometax
rules ever followed in China. The three classes of income subjected to the tax were business income, compensation for service, and interest and dividends. Enforcement of these rules began October 1st, 1936 and was the first act to be successful.

In April, 1946, these Income Tax Regulations were replaced by the Income Tax Law which is still effective. Some aspects of the regulations which were improved upon in the formulation of the Law will be discussed in the succeeding chapter.

---

Chapter 3

ASPECTS OF THE PRESENT INCOME TAX LAW WHICH ARE IMPROVEMENTS OVER THE 1936 REGULATIONS

A. Scope

The scope of the income tax is broader in the present law than in the previous regulations. In the new law, the tax is applicable to more kinds of income and to larger income groups. Under the new law, all kinds of income are taxable, while under the old regulations, there were only three classes of income that were taxable. The new law defines the taxable income as "All the income earned in the Chinese territory as well as all the income earned in foreign countries by individuals (or groups) who have established permanent residence in China".

B. Rate

The effective rates of income tax are generally higher in the present law than in the former regulations. For instance, the maximum rate of tax on business income has been raised from twenty to thirty percent. The rate of tax on interest income has been raised from five to ten percent. But the maximum rate of tax on the income from

compensation for service has been reduced from thirty percent to ten percent for the salaried class and twenty percent for the professional class respectively.

C. Rental Income

Under the former regulations, rental income was not taxable because it was subject to another type of tax known as the "Tax on Property Rent and Gains from Selling of Properties". Since this tax had been avoided previous to the introduction of the new law, rental income is now inclosed in taxable income under the present Income Tax Law.

D. Income Earned by Government Enterprises

Under the former regulations, income earned by government owned enterprises was not taxable. Since this rule rendered competition too difficult for private businesses, the present law finds the income earned by the government enterprises taxable.

E. Exemptions

For a business in the form of a corporation, the net income equalling less than ten percent of its capital was exempted from tax under the previous regulations. Under the present law, however, the exemption is limited to the amount of net income which equals less than five percent

of its capital.

F. Over-all Income Tax

The introduction of the over-all income tax is the best advantage of the present Income Tax Law over the former Regulations. The classified income tax alone is insufficient to carry out the ideals of fairness in "ability to pay" and "equality of burden", because it imposes a heavier burden on those who have smaller incomes than those with larger ones. If the over-all income tax were used instead of the classified income tax, the progressive rates applied on an individual's total income would bring about more fairness. However, existing conditions in China make it difficult to carry out a plan. Incomplete registration of citizenship places an enormous handicap on the investigation of individuals' income. One person might have several accounts with different names, thus making investigation by income tax authorities very costly and yet by no means successful. Therefore the over-all income tax as the only tax is not practicable at this time.

A combination of the classified income tax and the over-all income tax eliminates the defects and incorporates


the advantages of both systems. The classified income tax requires comparatively little operational expense, because collection at the sources facilitates administration as well as investigation. Moreover, the introduction of the over-all income tax does not call for much additional expense, because the total income of an individual is merely the sum of his income from different sources. Therefore, the combination of both systems serves the purposes of increasing revenue and being fair to the taxpayers.  

G. Other Changes

The present law divides business into two classes; corporation and otherwise. The tax rates are more favorable to an enterprise in the form of an corporation than to a business organized in any other way. This factor is good in that it encourages people to have their business enterprises incorporated. Another excellent part of the new law provides for a ten percent reduction in the tax rates for mining and manufacturing concerns. This indicates the intention of the Chinese government to encourage the production.

PART II

THE PRESENT INCOME TAX LAW SINCE APRIL 16, 1946
Chapter 4
GENERAL PROVISIONS

The present income tax law was promulgated on April 16th, 1946, and had been carried out since that date.

A. Scope of the Income Tax Law

The scope of this income tax law is as follows:
1. All income earned in the Chinese territory is subject to this Income Tax Law.
2. Income earned in foreign countries by Chinese citizens who have permanent residence in China is also subject to this Income Tax Law.

Exception: Income earned by foreign diplomatic services to China in connection with official functions is not subject to this Income Tax Law. This privilege is given only to those countries who reciprocate the same preferential treatment.

B. Method of Computation of Income Tax

The method used for computation of the income tax is to classify the income into different classes according to their respective sources. Different rates are applied to different classes of income in order to realize the concept of "equality of burden". The classifications by source of

income are as follows:

1. Business income
   a. Corporation.
   b. Partnership and single proprietorship.

2. Compensation for service
   a. Professional class.
   b. Salaried class.

3. Rent
   a. Land and building.
   b. Machinery.

4. Interest and dividend.

5. Other income.

A certain amount of the income from each class is exempt from tax, and certain deductions are allowed in determining the net income of certain of these classes. These rules will be discussed in detail in the later chapters. In addition to the tax computed according to the classifications by source of income, there is an over-all income tax on the individual's total annual net income provided that the latter, regardless of the source, is in excess of six hundred thousand dollars of Chinese national currency. The rules applicable to this provision will be covered in detail in chapter 10.

C. Investigation and Collection
The taxpayer, or tax withholding, files a tax return with the commissioner who investigates the return to see if the amount of income and other items declared are proper, determines the amount of tax to be paid, and informs the taxpayer. After the information has been received from the commissioner, the taxpayer must pay the tax within a certain number of days, the number varying for the different classes of income. If the taxpayer does not agree with the amount of tax determined by the commissioner, he may apply for reinvestigation with proper reasons indicated, but he must pay within ten days one half of the tax as determined by the commissioner, and in addition, he must pay within thirty days one third of the over-all tax, if any, on his combined income. If the revised amount of tax is satisfactory to the taxpayer, then he must pay the tax within ten days and the tax on his combined income within thirty days. If the amount of tax determined after reinvestigation is still not satisfactory to the taxpayer, the case can be brought into court, and the court will determine the proper amount of the tax.

D. Fine

If the taxpayer, or the tax withholding, neglects
to file the tax return, or files the return after the fixed time, he is subject to a fine up to twenty five thousand dollars. If, by any means, the taxpayer is trying to evade the tax, the tax commissioner will bring suit against him. In addition to the tax for which he is liable, he is also subject to a fine of from two to five times the amount he tried to evade, and, if the condition is serious, he might be imprisoned.

Chapter 5
BUSINESS INCOME

Business income means the income earned by all business enterprises owned either by private individuals or by the government. These enterprises are divided into two classes according to their type of organization. The rates and methods of computation of income tax for the two types of enterprises are different and will be discussed in detail. The two classes of enterprises are:

A. Corporation.

B. Partnership and single proprietorship.

If the enterprise consists of home office and branches, and if the home office is in China, the income earned by the branches either in China or in foreign countries should be included in the gross income of the home office. If the home office is abroad and the branch is in China, only the income earned by the branch is subject to the income tax. If the branch is entirely independent from the home office - that is, the branch has a definite amount of capital of its own, or is incorporated by itself and has a separate set of books and is doing business independently, the branch may file its own return. The income of that branch need not be included in the income of the home office.
A. Corporation

A corporation is a business enterprise incorporated according to the Corporation Law and registered at the Ministry of Industry and Commerce. The computation of the income tax for this class of business enterprise is comparatively complicated. The tax rate varies with the ratio of the amount of net income to the amount of capital. If the ratio of the income to the capital is higher, the rate will be higher too, but not in the same proportion. In computing the income tax, the following steps should be taken:

1. Determine the amount of capital.
2. Determine the amount of net income.
3. Find the ratio of the net income to the capital.
4. Find tax rate for that ratio in the table.
5. Determine the amount of tax liability.

Example: Assume Corporation K has a Capital amounting to $500,000 and a net income of $160,000 for the year 1947. Find tax liability for K Corporation for the year 1947. The ratio is \( \frac{160}{500} \) or 32\%. The tax rate in the government table for 32\% is 16\% (shown in Table II). The amount of tax is equal to the net income \$160,000 times the rate 16\% equals \$25,000.

1. Direct Tax and Accounting, Shanghai University, Shanghai, 1946, p. 45.
The tax liability for the K Corporation for the year 1947 is $25,000.

1. Determination of the amount of capital

Where the amount of net income remains constant, determination of the amount of capital is very important because the amount of tax will vary inversely as the amount of capital. Consequently, the larger the capital, the smaller will be the ratio of the net income to the capital and vice versa.

The amount of capital is the sum of the capital stocks authorized and issued plus one third of the surplus which consists of earned surplus, capital surplus, sinking fund reserve, and any other reserves kept in the net worth section.

The amount for the capital stock is the amount actually received for capital stocks issued except that in the case of stocks issued at premium, the premium is considered as a capital surplus. Issuing at a discount is not allowed by the Corporation Law.

If the stocks are subscribed but not fully paid, only the paid part is carried as capital stock. Where the

2. Ibid., p. 3.
company has been reorganized during the taxable year, and the amount of capital stock has been decreased or increased for tax purposes, the amount of capital stock is neither determined by the amount at the beginning of the year, nor by the amount at the end of the year. Instead, it is determined by the average of the amount of capital stock at the beginning of each month. Likewise, surplus is also computed in the same way - that is, average of the amount of surplus at the beginning of each month in the taxable year. If the amount of capital stock is increased due to the collection of the unpaid subscriptions during the year, the amount of capital stock will be determined the same as mentioned above.

Example: The net worth section of Co. M at the end of the year 1947 is as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital stock</td>
<td>$5,000,000</td>
</tr>
<tr>
<td>Unpaid subscription</td>
<td>500,000</td>
</tr>
<tr>
<td>Sinking fund reserve</td>
<td>500,000</td>
</tr>
<tr>
<td>Contingency reserve</td>
<td>200,000</td>
</tr>
<tr>
<td>Surplus</td>
<td>130,000</td>
</tr>
</tbody>
</table>

An unpaid subscription of $1,000,000 had been collected on March, 1947. An amount of profit $100,000 had been closed into surplus during March, 1947, as was decided by the board of directors. The computation of the net amount of capital is as follows:

Capital stock for the first three months is $5,000,000 - $1,000,000 - $500,000 equalling $3,500,000.

---

1. Direct Tax and Accounting, *op. cit.*, chapter 6, part I, p. 45,46.
Capital stock for the remaining nine months is $5,000,000 - $500,000 equaling $4,500,000.
The average amount of capital stock is
($3,500,000 \times 3 / $4,500,000 \times 9 \times 12),
equaling $4,250,000.
Surplus for the first three months is
$500,000 / $200,000 / $30,000,
equaling $730,000.
Surplus for the remaining nine months is
$500,000 / $200,000 / $130,000,
equaling $830,000.
The average surplus is
($730,000 \times 3 / $830,000 \times 9 \times 12),
equaling $805,000.
The net amount of capital for the year 1947 is equal to $4,250,000 / 1/3 of
$805,000 which equals $4,250,000 / $268,333 or $4,518,333.

**Emergency Case**

If the company's books have been lost or they do
not show the actual situation of the company, the amount of
capital can be temporarily determined by revaluing all the
assets and liabilities. Then the difference between the va-
value of total tangible assets and total liabilities will be
the net amount of capital.

If any change in capital, capital stock as well
as surplus, has been made during the taxable year, the tax-
payer should report the change to the tax commissioner with-
in fifteen days after the change has been made.

p. 2.
2. **Determination of the amount of net income**

Net income equals; **gross income less deductions.**

The gross income consists of both the major operating income and the non-operating income earned by the business enterprises. The major operating income is the income earned by the business enterprise in connection with its major line of business such as:

- Retailer's sales margin;
- Manufacturer's gross profit which is the selling price less the cost of the goods manufactured;
- Rental income of the real estate business;
- Freight income of the transportation business;
- Interest income earned by the financial institutions;
- Commission income earned by the company as a broker.

The amount of income is determined on the accrued basis rather than on the cash basis - that is, the income is determined by the amount that should be received rather than by the amount that has been received. However, a few exceptions follow:

a. Profit on installment sales - only the profit on collected installments, the realized profit,

---

is considered as income.

b. Profit on work in process - no profit can be realized on work in process except in the cases of:

(1) Goods made to order.

(2) Long term contracts.

In the above cases, profit can be realized in proportion to the work that has been done.

If the goods are sold on future delivery, it is merely a contract to sell. Such contracts may very easily be forfeited, and the profit on these goods sold on future delivery is not therefore realized. Such profit need not be included in income until the delivery of goods has been made.

In regard to the rental income of a real estate business, and the interest income of the financial institutions, the income tax is always collected at the source of income - that is, an amount is always held as income tax by the rent payer or interest payer. The amount of income that should be included in the taxpayer's gross income is the amount of income without deducting any income tax. The amount of income tax withheld can be taken as a credit to the tax liability of the company.

2. Ibid., p. 52.
Non-operating income consists of all the income earned by the company outside its major line of business. All the non-operating income should be included in the gross income except rent, interest, and dividend which have their own classifications and are subject to their own rules.

Readjustment of asset value may be made if the asset value has been increased permanently or if the book value of the asset has been depreciated fully and the asset is still in good useful condition. An appraisal value may therefore be brought on the books, and that amount of increased value should be considered as non-operating income.

Deductions

The following deductions can be taken from the gross income in computing the amount of net income:

1. Direct expenses.
2. Bad debts.
3. Depreciation.
4. Losses due to spoilage and shortage of inventory.
5. Taxes.
6. Other losses.
7. Reserve fund.

(1) **Direct Expenses**

Direct expenses are those incurred directly in the major course of business of the company. These expenses must be reasonable and necessary. Reasonable means reasonable in amount, which can be determined by comparison with the market price, or the price paid by others under similar conditions. A necessary expense is one without which the business cannot be carried on satisfactorily. The amount of direct expense is determined on the accrued basis.

Direct expenses include the following:

a. Salary, consisting of wages, bonuses, allowances paid to and insurance premiums paid for workers.

b. Rent paid for the use of office or other property for the taxable year.

c. Maintenance and repairs.

d. Interest expense.

e. Delivery expense.

f. Advertising and insurance.

g. Telephone, telegraph, light, heat, power, and other general expenses.

h. A contribution may be considered as a neces-

---

sary expense only if;

1. The contribution is made to an institution which is promoted by the public and has been registered with the government.

2. The nation is directly benefited by such a contribution.

(2) **Bad Debts**

Bad debts means the uncollectible accounts receivable. Accounts receivable under the following conditions may be considered as bad debts:

a. If the debtor is insolvent, bankrupt, or cannot be found.

b. If the age of the account is more than two years and neither principle nor interest has been collected since the sale has been made.

The amount of bad debts is deductible only to the extent that these accounts meet one of the above mentioned conditions and are actually written off on the books.

The recovery of bad debts which have been previously written off should be included in the non-operating income for the year of recovery.

---

(3) **Depreciation**

In order to find the amount of depreciation for fixed assets for the taxable year, the following items should be taken into consideration:

a. The basis of the property.
b. Useful time.
c. Residual value.
d. Depreciation rate.
e. The amount of depreciation for each year.

The basis of the property valuation is the cost plus any other capital expenditures applied to that property.

The useful period is dependent upon the physical structure of the property, the operating condition, repairing policy of the firm, obsolescence, and contract terms. The better the physical structure and operating condition, and the more frequently it is repaired, the longer the useful life of the property will be. Sometimes the useful life is limited by obsolescence and contracts, such as a building which was built on a piece of leased land. Here the useful life of the building is limited by the lease. For tax purposes, the useful life of certain kinds of properties is determined by the commissioner as the minimum useful period.

---

over which to write off the value of the property in the form of depreciation, as will be shown in Table I.

**TABLE I**

**MINIMUM USEFUL LIFE FOR COMPUTATION OF DEPRECIATION**

<table>
<thead>
<tr>
<th>KINDS OF PROPERTIES</th>
<th>PHYSICAL STRUCTURE</th>
<th>USEFUL LIFE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Building</td>
<td>Iron and steel</td>
<td>50 years</td>
</tr>
<tr>
<td></td>
<td>Cement and steel</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>Brick</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>Wooden</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>Earth</td>
<td>5</td>
</tr>
<tr>
<td>Furnishing</td>
<td>Steel, wooden etc.</td>
<td>10</td>
</tr>
<tr>
<td>Boat and ship</td>
<td>Steel</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>Wooden</td>
<td>10</td>
</tr>
<tr>
<td>Machinery</td>
<td>Steel</td>
<td>12</td>
</tr>
<tr>
<td></td>
<td>Wooden</td>
<td>6</td>
</tr>
<tr>
<td>Tools</td>
<td>Steel</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>Wooden</td>
<td>2</td>
</tr>
<tr>
<td>Furniture and fixture</td>
<td>Steel</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>Wooden</td>
<td>5</td>
</tr>
</tbody>
</table>


Residual value is the estimated scrap value of the property at the end of the useful life.

The depreciation is determined by the straight line method - that is, by dividing the original value less the scrap value of the property by the number of years of
the useful life of the property. Depreciation rate equals 100% divided by useful life. If the period of use is less than a year, the amount of deduction allowed for depreciation is computed in the same way in proportion as the period of use is to the year. If the value of the property has been appraised and the appraised value has been taken as income, a depreciation deduction is allowed on the appraised value for the rest of the useful life.

The amount of depreciation equals; (basis of the property - scrap value) X depreciation rate.

Depletion

The amount of depletion is computed on the straight basis - that is, the rate of depletion is determined by dividing the discovery cost of the mine, or other natural resource, by the estimated remaining mineral units.

The amount of depletion is determined by multiplying the depletion rate either by the units sold or the units produced during the taxable year, depending on which one is chosen by the taxpayer, but the taxpayer must follow the one he has chosen in computing the depletion for the succeeding years.

Amortization of the value of the intangible assets

The basis for the intangible asset is the price paid for it, the value of which may be amortized on the straight line basis over the legal life as indicated below:

b. Copy-right - fifteen years.
c. Trade mark - three years.

(4) Losses due to spoilage or shortage of inventory

When a physical inventory is taken and the value is less than the amount on the books, the difference is deductible as a loss.

(5) Taxes

Taxes include all taxes, fees, and assessments which are levied either by the Municipal or Central Government. All taxes are deductible except the income tax. The income tax paid for the last year's income is not deductible. The income tax withheld by the rent or interest payer during the taxable year is a credit to the tax liability of the company for the current year, but it is not a deduction. The amount to be credited to the tax liability is determined by the amount withheld or that portion of income tax applicable to the taxed income whichever is lower. The portion of the tax applicable to the taxed income is computed in the

2. Ibid, p. 63.
same proportion as the amount of taxed income to the total net income.

(6) Other Losses

The following losses are deductible:

a. Loss on selling of fixed asset - the amount of loss is determined by the difference between the selling price of the asset and its depreciated value.

b. Causality loss.

Non-business loss is not deductible. non-business loss is the loss incurred not in connection with the major or minor course of the business of the taxpayer.

(7) Reserve fund

This is a fund set aside for a particular purpose. A certain amount will be contributed to the fund every year. Such a contribution is deductible if the fund is registered at and has been approved by the tax commissioner's office.

Non-deductible items

The following items are absolutely not deductible:

1. Dividends to stockholders.

2. Family and personal expenses.

2. Ibid., p. 63.
3. Ibid., p. 63.
4. Social expenses.
5. Fines.
6. Capital expenditures which will increase the value or prolong the life of the property.
7. Losses incurred other than in the major or minor course of the business.
8. Causality losses which are compensated by insurance.
9. The net operating loss of the preceding year.
10. Entertainment expense.

Example: Co. M has an operating income of $500,000 and a non-operating income of $20,000, direct expense of $200,000, bad debts of $20,000, depreciation of $50,000 on building and machinery, loss on selling of stock investment of $30,000, loss on spoilage of inventory of $25,000, one of the factory building which had a depreciated value of $200,000 was burned and $180,000 had been received from the insurance company as compensation, for the year of 1947.

The computation of net income of Co. M is as follows:

Total income equals;
$500,000 plus $20,000 equals $520,000

Deductions are:
- Direct expense $200,000
- Bad debts 20,000
- Depreciation 50,000
Deductions (continued)

Loss on inventory  25,000
Fire loss  20,000

Total deduction equals $315,000

Net income equals;
$520,000 minus $315,000
or $205,000.

3. Ratio

For tax purposes, the ratio of the amount of net income to the amount of capital is very important because the tax rate depends on the ratio.

Ratio equals the net income divided by capital.

Example: The ratio in the above example (for Co. M) is:

Net income  $205,000
Capital  $ 4,518,333
Ratio equals;
205/4,518 or 4.5%

4. Rate

The tax rates will be found in the government table. (shown in Table II)

If the nature of the business of the company (taxpayer) is in manufacturing or mining, the rate will be ten percent less as shown in Table II - that is, 3.6% for the first item instead of 4%.

### TABLE II

**TAX RATES FOR CORPORATIONS**

<table>
<thead>
<tr>
<th>RATIO</th>
<th>RATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>below</td>
<td>5%</td>
</tr>
<tr>
<td>from</td>
<td>5 to 10%</td>
</tr>
<tr>
<td></td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>25</td>
</tr>
<tr>
<td></td>
<td>30</td>
</tr>
<tr>
<td></td>
<td>35</td>
</tr>
<tr>
<td></td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>50 and over</td>
</tr>
</tbody>
</table>


5. The amount of tax

The tax liability is computed by multiplying the amount of net income by the tax rate.

Tax equals: net income X rate

**Cooperative Enterprise**

If the business enterprise is organized in the form of a cooperative enterprise and the amount of net income is less than twenty percent of its capital, such income is exempt from tax. Cooperative enterprise are limited to those which registered with the local government and are operating under the Cooperative Enterprise Law.

---

2. Ibid., p. 2.
If the amount of net income is greater than twenty percent of its capital, it is also taxable and subject to the rates as in the form of a corporation.

B. **Partnership and single proprietorship**

If the business enterprise is organized in the form of a partnership or single proprietorship or any form other than a corporation, the computation of income tax is different from the way mentioned in the corporation.

The amount of tax is determined by applying a straight rate on the amount of net income without regard to the ratio between the amount of net income and the amount of capital as in the case of a corporation.

The amount of net income is determined in the same way as that of the corporation except fewer deductions are allowed here than in the case of a corporation. For instance, any contribution to the reserve fund is not deductible here, and, in fact, there is rarely any reserve fund in the case of partnership or single proprietorship.

**Rate**

The tax rates are shown in Table III.

If the enterprise is a mining or manufacturing business concern, the rate will be ten percent less than the rate indicated in Table III. That will be 3.6\% for the

---

first item instead of 4%.

TABLE III
TAX RATES FOR BUSINESS ENTERPRISES
OTHER THAN CORPORATION

<table>
<thead>
<tr>
<th>NET INCOME</th>
<th>RATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>below $149,999</td>
<td>exempt</td>
</tr>
<tr>
<td>from $150,000 to $199,999</td>
<td>4%</td>
</tr>
<tr>
<td>$200,000</td>
<td>6</td>
</tr>
<tr>
<td>$300,000</td>
<td>8</td>
</tr>
<tr>
<td>$500,000</td>
<td>10</td>
</tr>
<tr>
<td>$800,000</td>
<td>12</td>
</tr>
<tr>
<td>$1,200,000</td>
<td>14</td>
</tr>
<tr>
<td>$1,800,000</td>
<td>16</td>
</tr>
<tr>
<td>$2,500,000</td>
<td>19</td>
</tr>
<tr>
<td>$3,500,000</td>
<td>22</td>
</tr>
<tr>
<td>$5,000,000</td>
<td>25</td>
</tr>
<tr>
<td>$7,000,000 and over</td>
<td>30</td>
</tr>
</tbody>
</table>


Example: The net income of A and B Partnership, a manufacturing concern, is $210,000 for the year 1947. The tax rate is 90% of 6% or 5.4%. The tax liability is: $210,000 x 5.4% equals $11,340.

Registration

Any business enterprise should apply for registration of the name, location, nature of the business, and any other items which influence the income tax, at the local tax commissioner within one month before the taxable year.
If the business enterprise is newly organized, registration should be made as regards the above mentioned items within fifteen days before the operation starts. If any changes will be made in the business enterprise, such as reorganization, liquidation, transferring of ownership, change of location, change of name, or termination of business, such changes should be registered with the commissioner within fifteen days before the change is to be made.

The commissioner will investigate immediately after the registration has been applied for, and he will accept the registration after his investigation of the facts has been completed.

Tax returns should be filed once a year, but the taxable year may be determined by mutual understandings between the taxpayer and the commissioner. Once a particular date has been adopted as the end of the taxable year, any change of the date must meet the commissioner's approval, and adjustments of tax must be made.

Other Comments

When the operating period of the business is less than a year. Since the tax rate is applicable to the amount of annual net income, based on the ratio between the amount of annual net income and the amount of capital, the actual

2. Ibid., p. 9.
net income must first be divided by that fraction of the year in which it was earned to get an estimated annual net income based on the full year. Dividing this estimated annual net income by the capital will give the income ratio from which the rate of tax can be determined. The tax liability will be the amount of actual net income times the tax rate. When the operating period is a fraction of a month, a full month is added.

Example: Company was organized and started its operation on April 1st, 1947. Dec. 31st was adopted as the end of each taxable year. At the end of the year 1947, its net income amounted to $180,000, and its capital was $1,500,000.

The computation of the tax liability of Co, M for the year 1947 is as follows:

The amount of net income $180,000 was earned in nine months, so the estimated annual net income will be; $180,000 X 12/9 or $240,000.

The ratio of the estimated annual net income to the capital will be; 240/1,500 or 16%

The tax rate for 16% of income ratio is 8% (from Table II)

The tax liability will be the amount of real net income times the rate; $180,000 X 8% equals $14,400.

Example: If the Co. M was a single proprietorship instead of a corporation, the computation of tax will be a little different, as follows:

The tax rate for $240,000, the amount of estimated annual net income, is 6% (shown in Table III) without regard to the amount of capital.

The tax liability will be;
$180,000 \times 6\% = $10,800.

If this firm is engaged in the mining or manufacturing business, the rate will be 10\% less.
Chapter 6

COMPENSATION FOR SERVICE

Compensation for service includes the income of the professional class for service rendered and salary received by the salaried class.

A. Professional Class

The professional class includes the doctor, lawyer, accountant, architect, artist, musician, writer, actress, broker and any other person who sells his service but is not subject to regular salary. Income of the above mentioned persons is subject to the following rules, but the income from other sources (not compensation for service) should be declared separately.

Computation

Total income minus deductions equals net income.

Net income times the rate will be the amount of tax.

Total income is the income earned during the taxable year for service rendered by the taxpayer in his profession.

Deductions

The following four items are deductible from the total income:

1. **Office Rent**

The rent paid in connection with his profession is deductible. If the private residence and his office are at the same place, rental is deductible only for the portion of the building used for the office, but not in excess of sixty percent of the total rent.

Example: The annual rent for the whole building is $50,000. If half of the building is used for office, then $25,000 is deductible.

In the above example, suppose the building has ten rooms. All the rooms are used for office but only one is used for residence. In this case only $30,000 is deductible. (60% of $50,000)

If the taxpayer owns the house used for office, the rent estimated is also deductible. The rent can be determined by comparison with the rental of a similar house.

2. **Salaries paid in connection with the profession**

The salaries paid in connection with the profession of the taxpayer is deductible, such as the salary of the

---

clerk in the accountant's office, nurse in the doctor's office etc.

3. Traveling expense in connection with the profession

This traveling expense is only deductible to the extent of thirty percent of the amount of the particular income to which the expense was connected.

4. Other direct and necessary expense in connection with the profession

Other direct and necessary expense includes the following:

a. Dues to associations.

b. Cost of food and lodging provided for office employees.

c. Repair of office equipment and tools.

d. Stationery and postage used in connection with his profession.

e. Tax paid in connection with his profession.

f. Other expenses paid for the client.

g. Equipment - the amount spent for equipment is deductible in full in the taxable year as a necessary expense instead of as a depreciation expense.


2. Ibid. p. 8.
deduction spreading over a number of years.

Rate

The annual net income not in excess of $150,000 dollars is exempt from tax. Only the excessive part (over $150,000) is taxable. The rates are shown in Table IV.

<table>
<thead>
<tr>
<th>AMOUNT OF NET INCOME</th>
<th>RATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>between $150,001 and $200,000</td>
<td>3%</td>
</tr>
<tr>
<td>200,001</td>
<td>4</td>
</tr>
<tr>
<td>300,001</td>
<td>5</td>
</tr>
<tr>
<td>400,001</td>
<td>6</td>
</tr>
<tr>
<td>600,001</td>
<td>8</td>
</tr>
<tr>
<td>800,001</td>
<td>10</td>
</tr>
<tr>
<td>1,200,001</td>
<td>12</td>
</tr>
<tr>
<td>1,600,001</td>
<td>14</td>
</tr>
<tr>
<td>2,400,001</td>
<td>17</td>
</tr>
<tr>
<td>3,200,001 and over</td>
<td>20</td>
</tr>
</tbody>
</table>


Example: A doctor's total income for the year 1946 was $550,000. The expenditures were office rent $40,000, nurse's salary $50,000, other necessary expense $66,000.

The net income is equal to:

$550,000 minus $156,000 or $394,000

$150,000 is exempt from tax
50,000 X 3% equals $1,500
100,000 X 4% " 4,000
94,000 X 5% " 3,800

$394,000 $9,300
The tax liability of the doctor for the year 1946 will be nine thousand and three hundred dollars.

Declaration

The taxpayer should declare the amount of taxable income in proper form to the authorities within thirty days after the close of the taxable year. The taxable year can be ended at any date, depending on the agreement made between the taxpayer and the authorities. If there is no definite agreement between the taxpayer and the authorities, then the end of the calendar year (December 31st) is the end of the taxable year.

Investigation

The authorities examine the taxpayer's declaration and then investigate to see if the amount of taxable income declared is correct. If not, the authorities determine the proper amount of taxable income, and inform the taxpayer the amount of tax that should be paid. The taxpayer should pay the tax within fifteen days after the information has been received.

Income of the taxpayer which is in terms of foreign currency should be exchanged into national currency at the

official rate of exchange for tax purposes. If the income is in the form of stocks, bonds, or other property, the fair market value of the property at the time received is the base for this tax purpose.

B. Salaried Class

The salaried class includes all the employees of both public or governmental organizations and private firms. The income of the salaried class may be in the form of salary, wages, allowances, bonuses, pensions, rewards, and any other compensations for the services rendered by the employee to the employer. Reimbursed expenses of government employees are not included in taxable income.

Computation

The income tax of this group is computed monthly by applying the rate to the monthly net income of the taxpayer. No deduction is allowed, except the insurance premium paid by the laborers, in getting the net amount of taxable income. Life insurance premiums paid by the employer for employee (laborer only) is not included in the employee's income. The premium paid by laborer for himself is deductible from his income.

4. Ibid., p. 8.
Exemptions

Some of the income and the income of certain people are exempt from income tax, as follows:

1. Monthly income of a person not in excess of $50,000 is exempt from tax.
2. Pension for the death or injury of government employees. The death or injury must be in connection with the employment.
4. Compensation for services rendered by the crippled.
5. Old age pension.
6. Pensions received by dependents.

Rate

The monthly net income not in excess of $50,000 is exempt from tax, only the excessive part is subject to the rates indicated in Table V.

<table>
<thead>
<tr>
<th>AMOUNT OF MONTHLY INCOME</th>
<th>RATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>between $50,000 and $60,000</td>
<td>0.7%</td>
</tr>
<tr>
<td>60,000</td>
<td>1.2</td>
</tr>
<tr>
<td>80,000</td>
<td>1.8</td>
</tr>
<tr>
<td>100,000</td>
<td></td>
</tr>
</tbody>
</table>

TABLE V (Cont'd)

<table>
<thead>
<tr>
<th>AMOUNT OF MONTHLY INCOME</th>
<th>RATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>between $100,000 and $120,000</td>
<td>2.4%</td>
</tr>
<tr>
<td>120,000</td>
<td>3.2</td>
</tr>
<tr>
<td>140,000</td>
<td>4.0</td>
</tr>
<tr>
<td>160,000</td>
<td>5.0</td>
</tr>
<tr>
<td>180,000</td>
<td>6.0</td>
</tr>
<tr>
<td>200,000</td>
<td>8.0</td>
</tr>
<tr>
<td>240,000 and over</td>
<td>10.0</td>
</tr>
</tbody>
</table>


Some special cases

Case No. 1 - A taxpayer who has a regular monthly salary, works only twenty days and then leaves his position. He receives only two third of his regular monthly salary. The amount of tax will be also two third of the amount of tax for his regular monthly salary.

Example: A, a factory foreman, has a monthly salary of $90,000. For some reason, he left the factory after he worked 20 days in the month of January. He received $60,000 from the factory, and did not have any other income in that month.

In computing his tax liability for the month of January, first of all, find the amount of tax for the regular salary $90,000 out of which $50,000 is exempt

1. Direct Tax and Accounting, Shanghai University, Shanghai, 1946, p. 73.
and the tax on the balance is computed as follows:

\[
\begin{align*}
10,000 \times 0.7\% & \text{ equals } 70 \\
20,000 \times 1.2 & \text{ " } 240 \\
10,000 \times 1.8 & \text{ " } 180 \\
& \text{ \underline{total } } 490
\end{align*}
\]

The tax liability for the regular salary is $490. Since he received only 2/3 of the salary, he needs only pay 2/3 of $490 or $326 as tax for the month of January.

Case No. 2 - If the taxpayer has any income (compensation for service) other than his regular salary, such as bonuses received at the end of the year, such income should be divided by the months worked and combined with the monthly salary as the base for tax purposes. The difference between the tax withheld and the tax liability on the combined base will be made up at the end of the year.

Example: B, a factory worker, has a monthly salary $55,000. At the end of the year, he received a bonus of $120,000 for the services rendered during the year.

The computation of his income tax liability are as follows:

Monthly tax withheld;

\[
\begin{align*}
5,000 \times 0.7\% & \text{ equals } 35 \\
\text{Total amount of tax withheld for the year;} & \text{ } 35 \times 12 = 420
\end{align*}
\]

Tax on the combined base:
Monthly salary of $55,000 plus the bonus for the month of $10,000 ($120,000/12) equals $65,000.
$50,000 exempt from tax
10,000 X 0.7% equals $70
5,000 X 1.2 " 60
$130 X 12 equals $1,560.
The difference between the tax withheld and the tax liability on the combined base:
$1,560 minus $420 equals $1,140.

B must pay income tax of $1,140, in addition to the monthly tax withheld.

Case No. 3. - Where the taxpayer has two jobs at the same time and therefore has two regular monthly salaries at different places, in computing his tax liability, the two salaries should be combined, applying the rate on the combined salary. The difference between the tax on the combined salary and the sum of the tax withheld at different sources should be made up each month.

Example: C, an office clerk, has a day time job and an evening job at different places. The monthly salary is $55,000 for each job.

The computation of his income tax liability is as follows:

Monthly tax withheld by each employer:
$5,000 X 0.7% equals $35.

---

1. Direct Tax and Accounting, Op. Cit., p. 73,74.
Tax on combined salaries:
Net income equals:
$55,000 X 2 or $110,000

$50,000 exempt
10,000 X 0.7% equal $70
20,000 X 1.2 " 240
20,000 X 1.8 " 360
10,000 X 2.4 " 240

$110,000 $910

C must pay $840, in addition to the $70 withheld, toward his income tax for the month.

Case No 4 - During the war, the government used to pay only a portion of the salary to government employees and would make it up in the succeeding month. In this case the net income of the employees for the month is the actual amount received and the tax is paid on that amount. On the succeeding month when the discrepancy is made up, the difference between the amount of tax that should have been paid on regular salary and the amount paid or withheld must be made up.

Example: D, a government employee, has a regular monthly salary of $65,000. Due to the war, government only paid 80% on a dollar for the salary of January, 1947. The other 20% was paid in Feb.

The computation of D's tax liability for

both Jan. and Feb. is as follows:

For the month of January;
80% of $65,000 is $52,000.
$50,000 exempt from tax
2,000 X 0.7% equals $14.
$14 had been withheld as tax for Jan.

For the month of February;
D received $65,000 regular salary
and $13,000 for the salary of Jan.
$50,000 exempt
10,000 X 0.7% equals $70
5,000 X 1.2 " 60
\[
\begin{array}{c|c}
\text{65,000} & \text{130} \\
\end{array}
\]
Tax on regular salary is $130.

D must pay $246 tax which includes
$130 on his Feb. regular salary and
$116 ($130 - $14) on his Jan. salary.

If the salary is on weekly, hourly, or daily basis,
the net income is the actual amount earned during the month.

Declaration

The income tax of this class is always deducted
by the employer. The employer should declare the amount of
withheld tax and pay it to the authorities once a month,
within ten days after the salary has been paid. If the tax-
payer has any other tax liability than the tax withheld, he
should declare it himself each month or at the end of the
year, within the ten days after he receives the salary.

\[\text{1. Income Tax Law, Op. Cit., p. 10.}\]
Chapter 7

RENT

Rental income may be divided into two classes:

A. Land and building which consists of land rent, house rent, warehouse rent, forest rent, and any other similar rents.

B. Machinery which consists of machinery rent, automobile rent, boat rent, pier rent, and any other similar rents.

Computation

In computing the income tax on rent, the following steps should be followed:

1. Determine the amount of gross income.
2. Determine the amount of net income.
3. Apply the specific rates on the net income.

Gross income is the total amount of rent of each class received by the taxpayer during the year. Gross income less deductions equals net income. By applying the specific rates on the amount of net income of each class, the amount of tax liability is computed. If there is a deposit for renting a house or any other property, interest on the deposit should be included in the gross income of the taxpayer,

the owner of the house.

Deductions

In determining the net rental income, the following deductions are allowed:

1. Expenses incurred during the year in connection with the property rented, such as maintenance expense and repairs.

2. Depreciation on the property rented.

3. Taxes paid for the property rented, such as property tax, license fee, and any other contributions paid in connection with the property rented.

The total amount of deductions cannot exceed twenty percent of the gross income. In other words deductions are only allowed up to twenty percent of the total rental income.

Exemptions

All rental income is taxable except in the following cases:

1. The annual net rental income not in excess of $50,000 is not taxable. If the annual net ren-

3. Ibid., p. 21.
tional income is in excess of $50,000, only the excessive part is taxable and subject to the rates indicated.

2. The rent on government property is exempt from income tax.

3. The rental on the properties owned by educational and religious institutions or the institutions of social works and any other non-profitable organizations are exempt from income tax, if the whole rental received will be used for the same purpose by that particular organization.

Rate

### TABLE VI
TAX RATES FOR RENTAL INCOME

<table>
<thead>
<tr>
<th>AMOUNT OF NET ANNUAL RENTAL INCOME</th>
<th>RATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>from $50,001 to $100,000</td>
<td>3%</td>
</tr>
<tr>
<td>100,001</td>
<td>4</td>
</tr>
<tr>
<td>150,001</td>
<td>5.5</td>
</tr>
<tr>
<td>250,001</td>
<td>6.6</td>
</tr>
<tr>
<td>400,000</td>
<td>7.7</td>
</tr>
<tr>
<td>600,001</td>
<td>8.8</td>
</tr>
<tr>
<td>900,001</td>
<td>11.0</td>
</tr>
<tr>
<td>1,200,001</td>
<td>13.2</td>
</tr>
<tr>
<td>2,000,001</td>
<td>15.4</td>
</tr>
<tr>
<td>3,000,001</td>
<td>18.7</td>
</tr>
<tr>
<td>5,000,001</td>
<td>23.1</td>
</tr>
<tr>
<td>7,000,001 and over</td>
<td>27.5</td>
</tr>
</tbody>
</table>

The tax rates for the two classes of rental income are different, the rates for class B being ten percent higher than the rates for class A. There is an exemption of $50,000 for each class of rental income every year. Therefore the tax on each class of rental income should be computed separately, and the rental income of the same class should be combined in computing the tax.

Example: M, the taxpayer, owns two houses rented for $20,000 a month each, a piece of land rented for $40,000 a year, and a machine rented for $80,000 a year.

The expenses incurred in connection with these properties rented are as follows: property tax paid for the land and buildings for the year is $30,000, depreciation on the buildings is $40,000, on the machinery is $15,000 for the year, repair on one of the buildings during the year is $20,000.

The computation of M's income tax liability for that year is as follows:

Gross income from class A rent:

$20,000 X 2 X 12 / $40,000 equals $520,000.

Deductions for class A rent;

depreciation $40,000

---

tax $30,000
repair $20,000
Total deductions for class A rent equals $90,000

The net income of class A equals:
$520,000 minus $90,000, or $430,000.

Computation of tax:
$50,000 exempt
50,000 X 3% equals $1,500
50,000 X 4 " 2,000
100,000 X 5 " 5,000
150,000 X 6 " 9,000
30,000 X 7 " 2,100

$430,000 $19,600

The tax on class A rental income is $19,600.

Gross income from class B rent is $80,000, less deduction for depreciation of $15,000, equals $65,000 net income.

Computation of tax:
$50,000 exempt
15,000 X 3.3% equals $495

The tax on class B rental income is $495.

The total tax liability of M is equaling $19,600 plus $495, or $20,095.

Other Comments
If the rent is paid in kind, for example a farmer may pay rent to his landlord in terms of rice instead of money, then the average price of rice for the three months after the rice was produced is used in valuing the rice paid and determining the amount of gross income of the landlord.

If the taxpayer owns a house used in his own business or profession and he has taken a deduction for the estimated rent of the house owned by himself as an expense incurred in connection with his business and profession, that amount of deduction for rent should be included in his rental income.

If the property rented is owned by several persons instead of one, those persons can only be considered as one legal person. There is only $50,000 exempt from tax out of the rental income, and not $50,000 exemption for each owner.

Declaration and Collection

Since the rent payer is responsible to the tax collection authorities for the amount of income tax on the rent he paid, he has the right to withhold an amount as income tax from the rent he paid. That amount is computed as if the rent paid is the only rental income of the landlord. The method of withholding the tax is dependent upon the agreement made between the rent payer and the owner of the property. The withholding tax may be deducted from either the rent of every month, or from the rent of some particular months, usually the last few monthly rental payments of the year. The rent payer has to file the tax return in

declaring the amount of tax withheld during the taxable year.

If the payment of rent is in kind or the rent receiver has more than one source of rental income, the rent receiver should file his own tax return, computing the tax according to the rules mentioned above. He would pay the difference between the amount of tax withheld by the rent payer and the amount of tax he should pay.

In filing the tax return, it should always be accompanied by the contract or other documents in order to prove the right amount of rent and to determine the right amount of tax.

The tax should be paid within fifteen days after the announcement of the correct amount of tax has been received from the authorities by the taxpayer who files his own return, and within ten days for the tax withholder.

Chapter 8
INTEREST AND DIVIDEND

This chapter consists of income from the following sources:

1. Deposit interest.
2. Dividend from stocks.
3. Bond interest.
4. Cash surrender value of life insurance policies over the amount of premiums paid.

The above mentioned income is subject to a flat rate of ten percent for income tax. The income is determined on the basis of the actual amount received. There is no deduction allowed in determining the net income.

A. Deposit Interest

Deposit interest means the interest received from money loaned out or on deposit. Interest earned by financial institutions is not included in this section, because interest earning is the major course of business of financial institutions. Interest to them, therefore, is profit.

A financial institution is defined as an institu-

tion whose major course of business is one of the following:

1. Granting loans and receiving deposits.
2. Buying and selling foreign exchange.
3. Discounting notes and acceptances.

It must be a member of its association.

Deposits consist of time deposit, demand deposit, savings accounts, regular check accounts, and annuities.

Under certain agreements between the bank and the taxpayer, the taxpayer can over draw a certain amount from his account. In computing the income tax, the interest can be offset by bank interest charges; the net balance will be the interest income of the taxpayer.

Exemptions

Interest income earned by the following organizations are exempt from the tax:

2. Laborers' and government employees' legal savings fund.
3. Fund of institutions of education, culture, public services, and social work.

Interest income earned by government departments are exempt from income tax only if the account is in the

---

2. Ibid., p. 78.
name of that department, but not in the name of any person as a representative. The laborers' and government employees' legal savings fund is limited by the Government Employees' Savings Regulations. Before these regulations were drawn up, any fund set up involuntarily for the benefit of all the workers of the organization or all the employees of the government departments without any discrimination in favor of any particular person could be considered as legal savings fund.

Educational institutions consist of all the public and private schools registered at the Ministry of Education or registered at provincial or municipal Department of Education. A fund set aside for a scholarship purpose under trusteeship and registered with the proper authorities may be considered the same as the fund of educational institutions; in other words, the interest income earned by such fund is also exempt from income tax.

The institutions of public services and social work are only limited to those registered with the government authorities. A fund provided by a certain individual and set aside for specific relief purposes may be considered the same as the fund of the institution of social works, if such fund was known to the public and registered with the

government authorities.

The interest income earned from the fund set aside by the institutions mentioned above is exempt from income tax only if these funds meet the following conditions:

a. Permanent nature.

b. The interest but not the principle is used.

c. Registered with the government authorities.

In other words, the fund must be set aside for a certain number of years, registered with the government authorities, and only the interest earned from the fund used to accomplish the specific purpose. The principle cannot be used without government consent during that period. So these fund are always deposited in the form of time deposits.

B. Dividends on stocks

Dividends on stocks consist of the dividends declared and paid by the corporation on its preferred stock as well as the common stock issued to the stockholders. The cash basis is used in determining the income from dividends - that is, the actual amount of dividend declared on common stock and the specific rate of dividend for preferred stock. The income tax is withheld by the corporation which declared

2. Ibid., p. 9.
the dividend, so that ten percent of the dividend declared is deducted for income tax at the time of payment of the dividend.

C. Bond Interest

The bond includes those issued by central, provincial, and municipal governments and corporations. All the bond interest is taxable, its possession and nature are immaterial - that is, even if the bond is held by government departments, or for any specific purposes, the interest from the bond is still taxable to the holder.

The income tax on bond interest is also collected at the source - that is, ten percent of the interest will be deducted at the time of the payment of interest.

Special Case

Between the interest dates, when the taxpayer discounts the interest coupons of his government bonds in the bank, the bank has the right to withhold the amount for income tax on bond interest as though it were the interest payment date.

Example: A owns $500,000 6% government bonds, the interest payment dates are January 31st and July 31st, twice a year. On January

2. Ibid., p. 75.
3. Ibid., p. 75.
4. Ibid., p. 79.
15th, A discounts the interest coupons at the Bank of China.

The computation of income tax on bond interest is as follows:

Half year interest payable on January 31st equals;

$500,000 \times 3\%$, or $15,000$.

Income tax on the half year bond interest equals;

$15,000 \times 10\%$, or $1,500$.

A will get $12,250$ from the interest coupons discounted — that is, $15,000$ bond interest less $1,250$ interest for the remaining half month, and less income tax $1,500$.

**Declaration and Collection**

The income tax on all interest and dividends and on the amount of the insurance policy cash surrender value received over the amount of premiums paid are collected at the source. The tax withholder, one who pays the interest and dividends, should declare the amount of tax withheld and pay the amount of withheld tax to the authorities within fifteen days after the interest or dividends has been paid. When the bank credits the taxpayer's account with the amount of interest earned on his deposit, this is considered the same as though the interest had been paid.

**Other Comments**

Interest earned by the home office from its branch, or vice versa, is not included in this chapter on interest and dividends and is not subject to the rules mentioned above.

Chapter 9
OTHER INCOME

Other income consists of all income which has not been included in any class of income mentioned in preceding chapters. This form of income is really not a class of income but merely serves the purpose of fulfilling the idea that all kinds of income are taxable.

The following cases are considered as other income:

1. Gains realized in liquidation of business enterprise. If the realized value of the assets is above their book value or the liabilities being paid less then the book value, there will be a gain realized which is taxable as other income. The net operating profit earned during the period of liquidation is also considered as other income.

2. The income when something has been done for the purpose of making profit by an individual or a group of people who don't have a name or a definite location for the business, and the nature of whose business is not permanent.

1. Direct Tax and Accounting, Op. Cit., p.64.
3. The income from the sale of the investment properties of an individual.

The income tax is computed on each item of income. The tax on income in excess of the $20,000 exemption is computed by the rate applicable to the successive brackets into which the excess falls according to the Table VII.

**TABLE VII**

<table>
<thead>
<tr>
<th>AMOUNT OF NET INCOME</th>
<th>RATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>below $20,000</td>
<td>exempt</td>
</tr>
<tr>
<td>from $20,000 to $50,000</td>
<td>6%</td>
</tr>
<tr>
<td></td>
<td>8</td>
</tr>
<tr>
<td>from $50,000 to $100,000</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>12</td>
</tr>
<tr>
<td>from $100,000 to $200,000</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>18</td>
</tr>
<tr>
<td>from $200,000 to $400,000</td>
<td>22</td>
</tr>
<tr>
<td></td>
<td>26</td>
</tr>
<tr>
<td>from $400,000 to $800,000</td>
<td>30</td>
</tr>
<tr>
<td>800,000 to $1,500,000</td>
<td></td>
</tr>
<tr>
<td>1,500,000 to $3,000,000</td>
<td></td>
</tr>
<tr>
<td>3,000,000 to $5,000,000</td>
<td></td>
</tr>
<tr>
<td>5,000,000 and over</td>
<td></td>
</tr>
</tbody>
</table>


In the case of realization and liquidation of a business enterprise, the amount of net income, if any, is determined as the amount realized in liquidation over the

amount of its book value, less the realization expenses.

In the case of investment property sold, the net gain is the selling price less the selling expense plus cost or depreciated value of the property.

Declaration

The taxpayer should file his return within ten days after any gain of this class has been realized. He should pay the tax within ten days after he receives the information which informs him of the amount of gain considered proper by the tax commissioner.

Example: X has a gain on sale of property of $40,000, gain on speculation of $500,000.

The computation of X's tax liability is as follows:

Tax on sale of property;
$20,000 exempt
20,000 $ 6% equals $1,200

Tax on speculation;
$30,000 exempt
30,000 $ 6% equals $1,800
50,000 $ 8% " 4,000
100,000 $ 10% " 10,000
200,000 $ 12% " 24,000
100,000 $ 15% " 15,000

$500,000 $54,000

2. Ibid., p. 24.
3. Ibid., p. 25.
Chapter 10
OVER-ALL TAX

An over-all tax is levied on the individual's total income for the taxable year without regard to the source of income if the individual's annual net income is in excess of six hundred thousand dollars. The amount of the annual total net income is the sum of the net income earned during the year from each of the following sources of income.

2. Compensation for service.
3. Interest and dividends.
4. Rental income.
5. Other income.

The determination of the net income for each classification has already been discussed in detail in the preceding chapters. If there is a net loss in one class, the loss cannot be offset by the net income of other classes, but the net income of that particular class is considered zero.

"Business income" in this sense means the income earned by the taxpayer through his business enterprise except

cept where the business is in the form of corporation. The distribution of profit by a corporation is in the form of dividends or interest which has already been covered in the interest and dividend class. If the taxpayer is the only proprietor of the enterprise, the net income of the firm for the year will be included in the business income of the taxpayer. If the taxpayer is a partner of the firm, then only his share of profit will be included in the business income.

Exemptions

There are a few exemptions that can be credited to the amount of net income. They are as follows:

1. There will be an exemption of $100,000 for each dependent of the taxpayer, if the dependent is economically dependent and in close relation to the taxpayer.

2. Among the dependents, if there is any one receiving middle school or higher education, an exemption of $50,000 more will be allowed for each of such dependents.

3. The amount of income tax paid under five classes of income will be a credit to the amount of net income since the total net income is the

---

sum of the net income from each class before the income tax has been deducted for each of the same classes.

If the taxpayer's dependent has any direct income, three fifth of that income should be included in the net income of the taxpayer. This direct income consists of compensation for service, and interest and dividends.

If the dependent becomes self-supporting during any part of the taxable year, the amount of exemption allowed the taxpayer, and the amount of dependent's income to be included in the net income of the taxpayer are in direct proportion to the part of the year during which he remained as his dependent.

Rate

| TABLE VIII |
| OVER-ALL INCOME TAX RATES |
| AMOUNT OF NET INCOME | RATE |
| below $600,000 to $1,000,000 | exempt |
| 1,000,000 to 2,000,000 | 5% |
| 2,000,000 to 4,000,000 | 6 |
| 4,000,000 to 6,000,000 | 8 |
| 6,000,000 to 8,000,000 | 10 |
| 8,000,000 to 10,000,000 | 13 |
| 10,000,000 to 15,000,000 | 16 |

TABLE VIII (cont'd)

<table>
<thead>
<tr>
<th>AMOUNT OF NET INCOME</th>
<th>RATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>from $15,000,000 to $20,000,000</td>
<td>24%</td>
</tr>
<tr>
<td>20,000,000</td>
<td>29</td>
</tr>
<tr>
<td>30,000,000</td>
<td>35</td>
</tr>
<tr>
<td>40,000,000</td>
<td>42</td>
</tr>
<tr>
<td>50,000,000 and over</td>
<td>50</td>
</tr>
</tbody>
</table>


In Table VIII, "net income" means the amount of annual net income of the taxpayer after the exemptions have been taken. A net income of $600,000 is not taxable for each individual taxpayer. The excess over $600,000 is taxable and subject to the respective rates indicated in Table VIII.

Example: Mr. Y has a business income of $500,000, interest and dividends income of $100,000, rental income of $200,000, compensation for service of $700,000, and a loss from sale of property of $100,000 and no other income, for the year of 1947. Income tax of $75,000 has been paid.

He has three sons and a wife, all economically dependent. One of the sons has a direct income of $80,000 for the current year and the other two sons are studying in college.

The computation of the over-all tax liability of Mr. Y is as follows:

The amount of net income:
- Bus. Income $500,000
- Int. and Div. $100,000
- Rental income $200,000
Compensation $700,000
Son's income 3/5 of $80,000 48,000
$1,548,000

Less exemptions;
Four dependents ($100,000 each) $400,000
Tuition for two ($50,000 each) 100,000
Income tax paid 75,000
$575,000

Taxable income;
$1,548,000 minus $575,000 equals $973,000.

Computation of tax;
$973,000
-) 600,000 exempt
373,000 X 5% equals $18,650

Mr. Y's over-all tax liability for the year 1947 is $18,650.

Price Index Relief

Due to the rapid rise of price level and the cost of living, the amount of exemptions and the rate of income tax cannot be changed frequently enough to meet the price changes in order to be fair to the taxpayers. New regulations were announced by the Ministry of Finance and became effective the 1st of January, 1948. In these regulations, the price index has been taken as the base for the computation of income tax; it may be considered as a relief to the taxpayers. The procedures of the relief are as follows:

1. Price Index

The general price index is made and announced monthly by the National Economic Research Bureau of China.
2. **Ratio**

Determine the ratio of price index of the current month over the price index of the month April, 1946, when this Income Tax Law was first made.

3. **Equivalent Income**

Find the amount of equivalent income by dividing the amount of income by the above ratio.

4. **Equivalent Income Tax**

Apply the income tax rates to the amount of equivalent income in computing the amount of equivalent income tax.

5. **The amount of Income Tax**

Multiply the amount of equivalent income tax by the ratio of price index to determine the amount of income tax in the form of present currency.
PART III

GENERAL DISCUSSION AND CONCLUSION
Chapter 11

SOME ACCOUNTING PROBLEMS INVOLVED
IN THE COMPUTATION OF INCOME TAX

The income tax is levied and computed on the amount of net income, and therefore the accuracy of the latter will greatly influence on the amount of tax. In order to determine the accuracy and fairness of the amount of net income, the following problems are involved:

1. Valuation of property.
2. Determination of the basis for computation of net income.
3. Determination of the period for a fiscal year or taxable year.
4. Distinction between capital expenditure and revenue expenditure.

A. Valuation of property

The properties and assets can be valued from two different point views, as a going concern, or, as at the time of liquidation.

General rules

1. As a going concern, the assets are always valued at cost or market, whichever is lower.
2. As at the time of liquidation, the value of the
assets is the market value.

Cost means the manufacturing cost, purchasing cost, or invoice cost plus any expenditure that can be capitalized and less any amount that has been depreciated. Market value means the market price at the date of asset valuation, the market price being determined either by the price announced in the market through the transactions of the day or from the price list published by trade associations.

In spite of the universal acceptability of the general rules, the method of valuation for individual types of assets may differ slightly from the general rules, because the characteristics of the various types of assets may be different.

Specific Cases
1. Current assets

Cash in the form of foreign exchange is valued at the official rate of exchange as of the closing date of the fiscal year. Any difference between the value at this closing date and the amount on the books will be recognized as a gain or deductible as a loss.

Accounts receivable, for tax purposes, are valued

1. Direct Tax and Accounting, Shanghai University, Shanghai, 1946, p. 37.
2. Ibid., p. 38.
at the full amount unless particular accounts were written off.

Temporary investments are valued at cost or market, whichever is lower. Cost includes the purchase price plus commissions paid and expense of transferring the title. But the amount paid for interest accrued to the purchase date should be deducted from the cost. Market price may be the average price in the market at the closing date of the fiscal year, or the average price for one month before the closing date of the fiscal year, if the market price fluctuates widely.

Inventory valuation varies with the nature of the business enterprises; in trading or manufacturing business, inventories are valued at cost or market, whichever is lower. The cost for a trading business is the purchase price plus any direct expense incurred in connection with the purchase. The cost os the inventories of a manufacturer is the cost of manufacturing which consists of the cost of material, direct labor expended and overhead applied. The market price is not the selling price but the purchase price of those factors of production at the date of valuation. In the manufacturing business, market price consists of the price of raw materials and direct labor expended plus the overhead applied at the date of valuation. The cost of the raw material inventory is determined by the average purchase price
of the material during the year, except those lots of material having specific price identification. The market price of goods in transit is the price of the local market at the place to which the goods are shipped. The work in process inventories are valued at the cost or market of the manufacturing cost, whichever is lower. The inventory of finished by-products is valued at the selling price less any selling expenses.

2. **Deferred charges**

All deferred charges are valued at cost. There are three kinds of deferred charges:

a. Prepaid expenses - such as prepaid rent, unexpired insurance, and prepaid interest and taxes.

b. Supplies - such as, stationery, postage, and minor factory supplies.

c. Capitalized expense - such as, organization expense, and advertising expense.

3. **Long term loans receivable and permanent investments**

Under Chinese income tax law, no particular method has been mentioned regarding the valuation of permanent investments and long term loans, but according to accounting

---

principles, these assets should be valued at cost because they are not intended for sale as a going concern.

4. **Fixed assets**

Fixed assets may be divided into three classes:

a. Non-depreciable fixed asset.

b. Depreciable fixed asset.

c. Wasting asset.

Non-depreciable fixed assets such as land are valued at cost, which consists of the purchase cost, plus improvement cost, and any other expense tending to increase the value of the land.

Depreciable fixed assets, such as buildings and machinery are valued at cost less depreciation.

Wasting assets - such as, forests, mines, and any other natural resource, are valued at cost less depletion. The value of the wasting assets will be decreased as more units of the resource are taken away. Hence, the amount of depletion is computed in direct proportion to the number of units taken away from the resource during the period.

5. **Intangible assets**

Intangible assets - such as, good-will, trade marks, copy rights, and franchises, are valued at cost less the amount amortized. Cost means the amount actually paid.

---

The amount amortized is the sum of the amounts which have been written off during the past years. The written off amount for each year is computed on the straight line base through the life of the asset.

B. **Determination of the basis for computation of net income**

There are two bases for computing the amount of net income:

1. **Accrued basis.**
2. **Cash basis.**

On the accrued basis, the amount of income is determined by the amount actually earned during the fiscal year instead of the amount received. The expense is the amount actually spent instead of paid. Therefore, the amount of unearned income should be excluded from income, and the unexpired expense is not deductible as an expense.

On the cash basis, the amount of net income is determined by the amount received less the amount expended during the year. The interest on deposits credited by the bank to the account of the taxpayer is considered as having been received by the taxpayer even on the cash basis.

The basis used to compute the amount of net income differs for the various classes of income. For business income, the accrued basis is used to compute the amount of net income. If there is any inconvenience using the accrued basis for computing the amount of net income, the cash basis
may be adopted with the consent of the tax commissioner. The taxpayer must be consistent in using the basis he choses unless he applies for a change of basis three months before the beginning of the taxable year and makes the necessary adjustments. Income from compensation for services is computed on the cash basis. Interest and dividend, rental, and other income are also computed on the cash basis.

C. Determination of a fiscal year

The income tax on certain classes of income is computed annually - such as, business income, rental income, and the income of professional class. The fiscal year may not coincide with the calendar year. Due to the custom, tradition, and the nature of certain businesses and professions, the books may be closed once a year on a certain date which determines the end of the fiscal year. Once the taxpayer adopts a certain date as the beginning or end of the fiscal year, he must adhere to that date unless he applies for a change at least three months before the beginning of the fiscal year. Adjustments should be made accordingly.

D. Distinction between capital expenditure and revenue expenditure

In order to show the real operating results of the

---

business and the real net amount of income, expenditures should be clearly divided into two classes: capital expenditures and revenue expenditures. Capital expenditure is the amount spent for the increase of asset or decrease of liability. Revenue expenditure is the amount spent toward the earning of income.

Only those expenditures which meet one of the following rules may be considered as capital expenditures, while the others are considered as revenue expenditures.

1. Expenditures made for obtaining assets or paying liabilities.
2. Expenditures increasing asset values.
3. Expenditures increasing the efficiency of asset.
4. Expenditures which prolong the useful life of assets.
5. Expenditures which benefit succeeding years as well as the current year.

Chapter 12

COMPARISON OF SOME ASPECTS OF THE
INCOME TAX IN CHINA AND THE FEDERAL
INCOME TAX OF THE UNITED STATES

A. Scope

As far as the scope of the income tax is concerned, it is quite similar in the Chinese income tax as in the Federal income tax of the United States.

1. All income earned within the territory of the nation is taxable.

2. All kinds of income are taxable except excluded or exempted as indicated.

B. System

U.S.) There are both Normal tax and Surtax levied on the annual net income of individuals and corporations.

China) The Chinese have a combination of two systems; the classified income tax by sources of income and the over-all income tax which is levied on an individual's total income, provided that his annual net income is in excess of $600,000.

C. Method of Computation, Investigation, and Collection

U.S.) The methods of computation, investigation and collection of income tax are different for the individual and for the corporation. The methods also vary with
the amount of net income of individuals (Long Form and Short Form Returns).

China) The methods of computation, investigation, and collection of income tax are different for different classes of income. The amount of tax on each class of income is computed separately. The over-all income tax is levied on the aggregate of all kinds of income from different sources earned by the individual.

D. Deductions

1. Distinction between the deductions for adjusted gross and other deductions
   U.S.) The distinction is very important.
   China) No such distinction.

2. Standard deduction
   U.S.) A standard deduction is allowed to be taken up to five hundred dollars.
   China) No standard deduction.

3. Non-business loss
   U.S.) Non-business loss is deductible to some extent.
   China) Non-business loss is not deductible.

4. Life insurance premium
   U.S.) Life insurance premium is not deductible.
   China) Life insurance premium paid by the laborer
is deductible from his taxable income.

E. Exemptions

U.S.) There is an amount of exemption which is allowed to be taken by the taxpayer for himself and each of his dependents. Interest income from the government obligations is partly or wholly exempted from tax.

China) There is an amount of income for each class of income exempted from tax. Also an amount of minimum cost of living and educational fee is allowed to be taken as an exemption in computing the over-all income tax. Interest income earned from the government obligations is also taxable.

F. Partnership and single proprietorship

U.S.) Income earned by partnership or single proprietorship is not taxable as such. The return filed by partnership is only an information return for the convenience of computation of individuals net income.

China) Income earned by partnerships or single proprietorships is taxable as such. When in computing the over-all income tax for individuals, the share of net income of each partner will be added to the total income of individuals.

G. Capital gain and loss

U.S.) There is provision for long term and short term capital gains and losses.
China) There is no such provision as capital gain and loss nor any distinction between the long term and short term transactions.

H. Miscellaneies

China) In computing the income tax for a corporation, the tax rates varies with the ratio of the amount of net income over the amount of capital instead of varying with the amount of net income alone as in the U.S. Federal Income Tax.
Chapter 13
DISCUSSION ON THE INCOME TAX IN CHINA

The conditions, existing in China now, make it impossible to test the value of the income tax fairly. The elasticity of the income tax is limited by the amount of surplus income of individuals or the difference between the earning capacity of the people and their respective cost of living. Now a days, most of the people in China have no surplus income; they cannot earn even the minimum living cost for the family, yet they must pay an income tax. This is one of the defects of the Chinese Income Tax Law. After the tax has been paid there is not quite enough money left to cover the minimum living cost of the family and so the amount of income tax paid by the individual is added to his living cost instead of just being levied on his surplus income. Neither does the income tax in China bring in sufficient income to support the government nor will it until the productivity and the earning capacity increase and thus bring a higher limit of elasticity to the income tax. The income of well to do people in China comes usually from various sources so they can get more exemptions then they need. The tax rates are not high enough for those people who have large incomes, so the amount of tax they pay is just a part, a small part of their net profit. Obviously,
the burden is not equal at all for the different classes of people so far as the ability to pay is concerned. As a result, the rich become richer and the poor become poorer. The accumulation of wealth on the one hand and the poverty on the other hand will make the class distinction more apparent. So income tax is no longer fair to the Chinese unless the income tax law can be revised. If the present conditions remain unchanged, the majority of the people, the good citizens, will become bankrupt or even go out of existence and honest business men will go out of business. Then where will be the sources of the income tax if the productivity and earning capacity of the people are killed? The income tax is no longer reliable and permanent until people have a reliable and permanent income.

In analyzing the present conditions in China, I found out some of the reasons which have made the situation so bad and which will make it worse if these factors continue to exist.

1. Inflation

Inflation is all powerful and disastrous; it makes the price level rise, it depreciates the value of money, it kills trade and commerce, it encourages speculation and it makes a hard way of living for the people. As far as the taxpayer is concerned, due to inflation, his high cost of living can hardly be balanced by his income, because the
rise of his income is not as fast as the rate of depreciation of the currency, and will result in the form of negative income - that is, from borrowing or using of savings to bear the tax burden. As for the government's point of view, inflation makes the currency depreciates so fast that the Treasury can hardly make good use of the money contributed by the taxpayers. It took months to complete the official procedures of computation and collection of income tax. The money was worth much more when the taxpayers made their sacrifices for the public benefit than when the money was received by the Treasury a few months later.

2. Imperfection of Accounting System

The imperfection of the accounting systems used in trade and commerce in China makes it very hard for the income tax authorities to investigate the real amount of net income in order to determine the amount of income tax due. The accounting used in trade and commerce in China is not standardized at all. The accounts consist only of the bookkeeping of business transactions, but they can hardly present the actual financial situation and the results of the operations. Although some of the accounting problems have been regulated by the tax authorities, yet these do not cover the whole field of accounting. Furthermore some of the firms make false bookkeepings and accounts trying
to avoid the tax. That makes it more complicated for the investigator to find out the real situations. Even if the authorities find out the actual conditions, the administrative expense is tremendous and leaves only a very small margin for the net revenue of the income tax.

3. Low Efficiency of Administration

The following factors makes the efficiency of administration very low:

a. Lack of experience.

b. Lack of specialized knowledge.

c. Lack of organization.

Personnel is one of the problems in the income tax administration. Most of the government employees are employed through the personal connections with the influential people in the government rather than through the public examinations on knowledge and experience. In fact, it is very hard to find the right person for a particular job within the limited scope of personal connections. Furthermore the chief official changes his position very often so his followers have to follow their boss to another job or lose the present job anyway. The frequent changes of positions makes it very hard for the government employees to gain much experience from each job. The inexperienced employees and their lack of specialized knowledge make the investigation and collection of income tax very slow and
costly yet the avoidance of tax still cannot be prevented. As regards the organization of the tax authorities, the responsibilities and authorities are not as clear cut as they should be, so no one is definitely responsible for doing something without asking the permissions of the others. That makes the procedures of investigation and collection of tax very slow, and it is especially bad at the time of inflation.

The avoidance of tax, the low efficiency of administration, and other unfavorable conditions make the net revenue from income tax very low. Furthermore this small amount of revenue will be deprived again by the depreciation of currency, so it is impossible to meet the public expenditures in performing the functions as planned. Yet some functions still must be done, so money has to be raised either by increasing the rates of income tax or by finding other sources of public income. As a result, the poor taxpayers who cannot or don't want to avoid the tax will bear the heavy tax burden until they are out of existence.
Chapter 14
FUTURE OF INCOME TAX IN CHINA

Inspite of the defects, disadvantages of and the unfavorable conditions of the income tax and its administration, its future in China is still bright and hopeful. When there is real peace and order in China and everyone can really have a chance to devote his energy toward developing production, there will result an increase in the income of the majority of the people of the nation, the wealth of the nation and the source of the public income. Then no one will ever try to avoid the tax, because they can afford to pay the tax. I sincerely believe everyone in China wants to be a good citizen just as in any other country, unless there is a force which is so powerful and influential that it makes a person break the law. At present, this force in China is the struggling for existence of mankind. The avoidance of tax is not because the law of penalty is not strict enough, but it is a barometer which indicates the lack of ability of the people to bear the tax burden, for whenever people can live under the guidance and protection of law, no one wants to break it.

At the same time, the public expenditures in the peace will not be so tremendous as now. This might be able to stop the desperate issuing of bank notes by which the
development of the income tax has been handicapped and much damage has been caused.

If peace can ever be realized in China, so every bit of money contributed by and collected from the people will be used entirely for productive and constructive purposes, the people will be benefited. Then the tax would be the accumulation of the saving of the people with which a lot of great projects could be performed. The people of the whole nation will be benifited by such projects. As we know people are benifited by a good tax system in a nation so it is also the responsibility of the people to improve the tax system, to elect the representatives to carry out the plan and to check the administration and the result of operations.

I believe all the defects of income tax and the unfavorable conditions relative to it can be wholly eliminated or improved if people are really interested in it. People know their own interests better than any others do. If people can elect the representatives who would really represent them and stand for their interest, and provided that the law is passed by the majority of the representatives elected by the different groups of people, then this law is fair, because it was made by the people and protects the interest of the majority of the people. In regard to the income tax, it is worthwhile to have some idea in mind for
solving the following problems:

How can we improve the income tax system?

How can we improve the income tax administration?

Then whenever we have a chance to suggest improvements, at least we can contribute some constructive ideas.

I personally believe that the failure of income tax in China is largely due to the unfavorable conditions and the ineffective administration. Of course the tax system itself is by no means perfect, but it is the one of the best combinations under the worst condition. I also believe income tax will be very helpful to the public finance in China in normal times, in the long run. It has an intangible value besides just bringing revenue to the government. For instance:

1. Income tax will make people conscious of their close relations with the government.

2. Income tax will make people interested in politics, in checking the efficiency of public administration, because the fund used by the government has been directly contributed by the people in the form of income tax. Every bit of waste in the public expenditure will increase the burden of the people.

3. Income tax will help to make people take part in voting and election and will reinforce the
realization of democracy.

4. Income tax is a kind of free education of political knowledge which tells the people that government is no longer any independent organization, but it is an organization of a group of representatives elected by the people and working for the benefit of the people.

5. Besides, the income tax administrative authority will supply very valuable data for the purpose of planning economy - such as:

   a. Tendency of growth of population.
   b. Trend of growth of national wealth.
   c. Distribution of wealth.
   d. Sources of individuals income.
A. Books


B. Magazine Articles


C. Pamphlets


Direct Tax and Accounting, Shanghai University Press, Shanghai, 1946.


Methods of Valuation of Property for Business Enterprise, Ministry of Finance, Nanking, March, 1946.
A study of the present income tax law in China

<table>
<thead>
<tr>
<th>DATE</th>
<th>ISSUED TO</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.00</td>
<td>T. Krishnakrishna</td>
</tr>
</tbody>
</table>