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Tax Non-Compliance of the Private
Businesses in Southeast China

中國東南地區私營企業的稅收不遵從

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Abstract

How do we explain the widespread tax evasion occurring in China? What are the motivations, concerns, and opportunities that have shaped the behaviour patterns of taxpayers? Drawing on the ethnography of 65 private businesses in the shoe industry and other industries in southeast China, this thesis provides empirical evidence to aid an understanding of local taxpaying practices, as well as a conceptual framework of compliance more generally. I argue that both opportunities to evade tax and social norms to comply work together in shaping tax compliance. A two-by-two matrix helps us to understand the following types of behaviour: aggressive evasion, obliged compliance, strategic compliance, and voluntary compliance. This framework explains why VAT (value-added tax) fraud is widespread in China, but voluntary compliance is rare.

This study also separately examines the role of two dimensions. On the one hand, the divergence of structural opportunities to evade tax results from the dynamics between social and institutional opportunities. One group of taxpayers had high levels of opportunities to evade tax due to two strokes of luck (i.e., their social and institutional opportunities to evade tax were both high), while the other group's social and institutional opportunities to evade tax were both low. On the other hand, procedural norms appeared to play only a small role in enhancing tax compliance in present-day China; instead, substantive norms, that is, individual, vertical, horizontal, and exchange norms, are important in understanding why the majority of small and medium-sized businesses are unwilling to pay taxes.

A useful theoretical framework has to survive application beyond its original context. The typology of my framework is not limited to this case study; it can be broadly applied to understanding (non) compliance in other jurisdictions and regulatory fields. A two-pronged regulatory strategy, which suggests that only when social norms and the opportunity to evade tax are improved together can the overall compliance level be substantially enhanced, is proposed to improve compliance in both China and other countries.

Acknowledgements

The opening of *The Old Man and The Sea* quotes: “He was an old man who fished alone in a skiff in the Gulf Stream and he had gone eighty-four days now without taking a fish.” It appears quite common that an academic researcher gains nothing in eighty-four days or even longer time. This dissertation has gone through a lengthy intellectual and personal journey. However, I am luckier than the old man because many people have in one way or another helped me get to this point.

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Abbreviation

VAT	Value-Added Taxes
GDP	Gross Domestic Product
BT	Business Tax
GTP	Golden Tax Project
SOEs	State-Owned Enterprises
SAT	State Administration of Taxation
VATSI	VAT Special Invoice
VATGI	VAT General Invoice
SGI	State General Invoice
LGI	Local General Invoice
EGI	Electronic General Invoice
MOF	Ministry of Finance
NPC	National People's Congress
CPC	Communist Party of China
IRS	Internal Revenue Service

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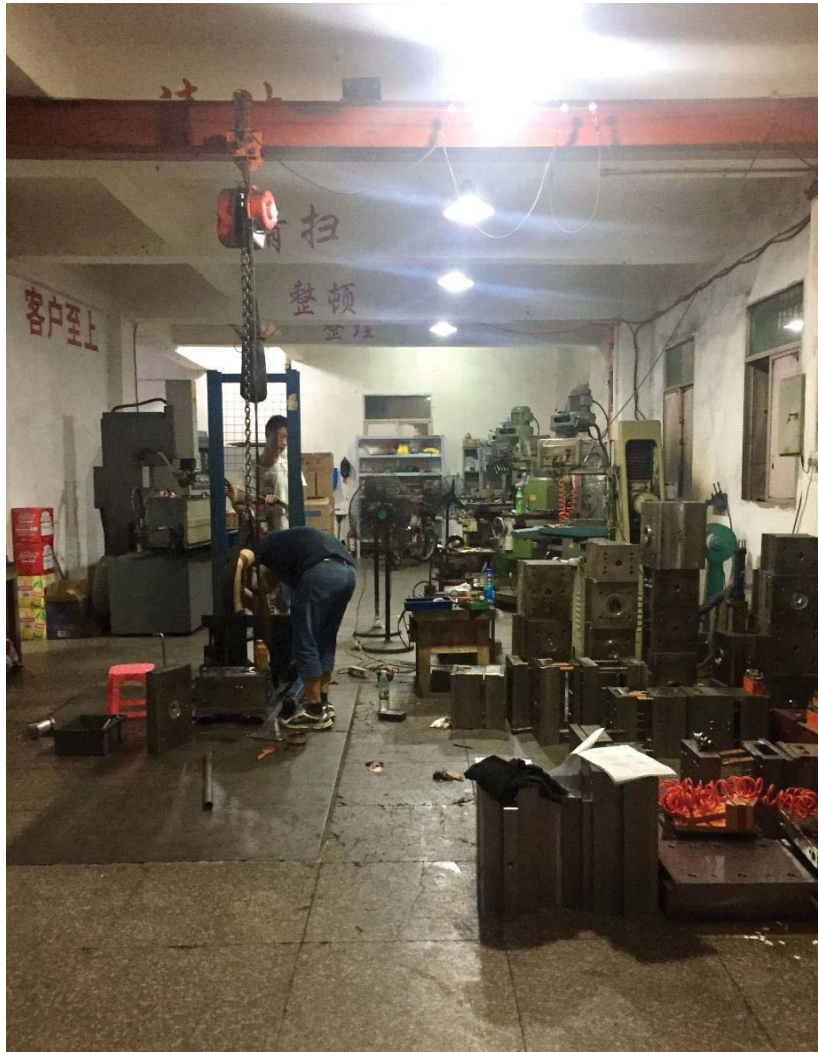
It is a wholesale market of shoe materials, one of the landmark industrial buildings of City Q, with an area of 200,000 square meters and a total of 2000 shoe businesses.

Figure 1. “The City of Shoes” in City Q



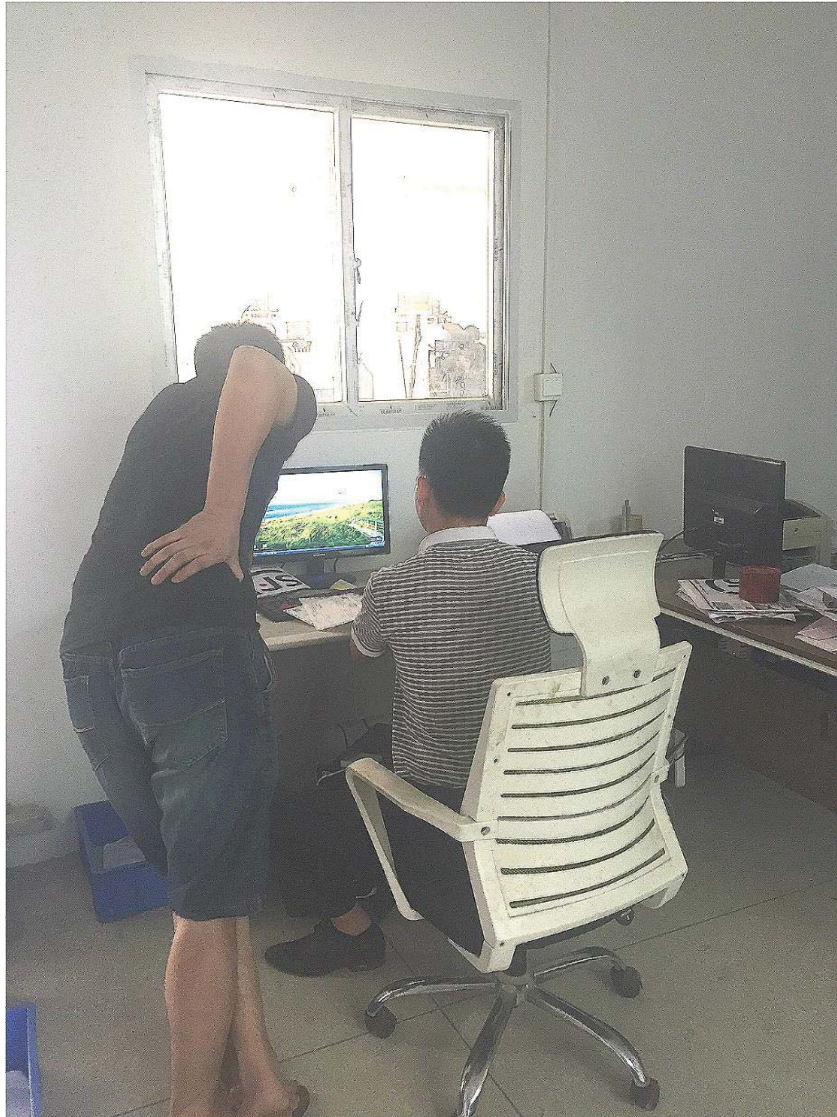
The Company, with 20 million RMB in gross income and 200 workers in 2016, had yet to register with the tax authorities, despite doing business since 2009. The photo shows one of the procedures of manufacturing shoes in the venue of this company.

Figure 2. An Unregistered Shoe Manufacturer in City Q



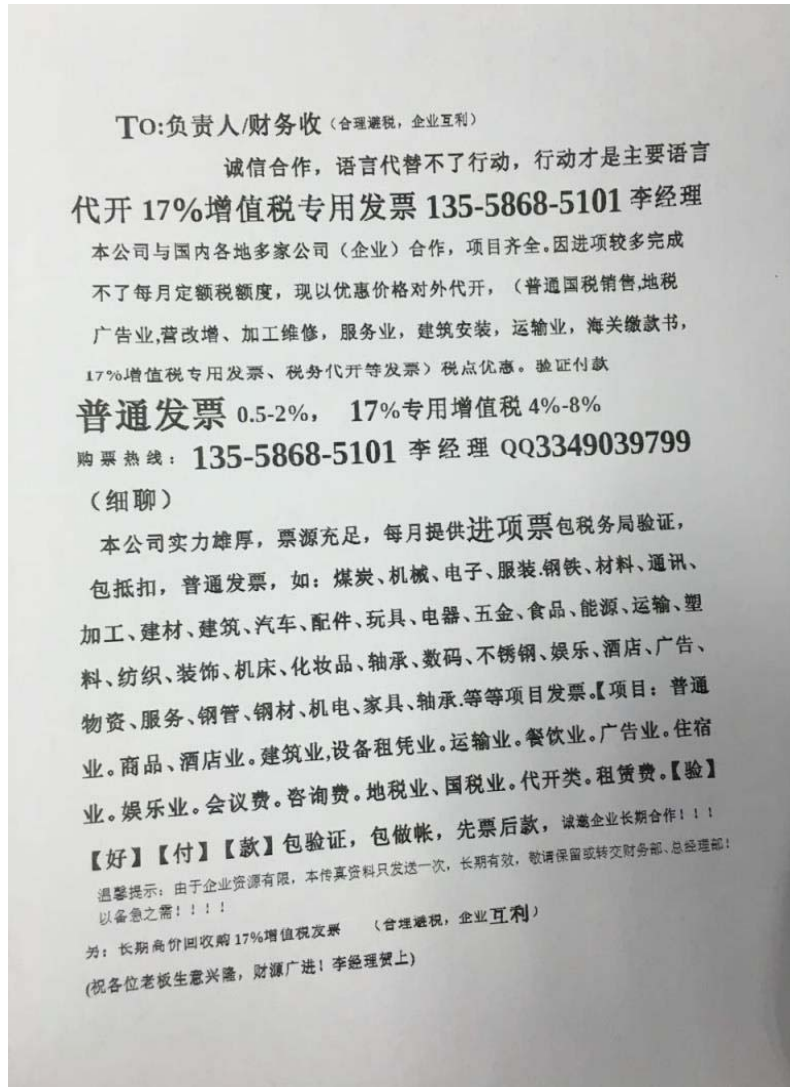
It is a manufacturer of hardware mould, with 1 million in turnover and five employees in 2016, located in one of the largest migrant villages in City S. In the above picture, one employee is weighting the iron mould.

Figure 3. A Factory in City S



A part-time tax preparer (seated) is helping an owner to verify input VAT invoices online. This is a fixed routine at his monthly visits to his clients.

Figure 4. A Part-Time Tax Preparer and His Corporate Client in City S



Tens of such flyers were collected during my investigations. These flyers are often faxed to companies, intending to promote their illegally issued input VAT invoices. In page two, I translated some of the information in this flyer.

Figure 5. A Flyer of Promoting Fraudulent Invoices in City Q

Introduction

A Bird's Eye View of the Nationwide VAT Evasions in China

Formally established in 1994, value-added tax (VAT) contributed 25.89 per cent of the annual tax revenue, which is the pillar of the tax system, in 2014 in China.¹ Businesses are required to pass on to the purchaser an output invoice to show the amount of tax charged and to receive an input invoice that is issued by the suppliers of the services or goods.

Tax evasion, however, is rampant in China. A *New York Times* report read, 'In China, businesses have to give out invoices called *fapiao* to ensure that taxes are being paid. But the *fapiao*—the very mechanism intended to keep businesses honest—is sometimes the key to cheating on taxes'.² 'It is often joked that the first words that a foreign businessman learns upon arriving in China is not *nihao* but is instead *fapiao*, meaning invoice'.³ In general, business taxpayers adopt two strategies to evade VAT. First, taxpayers avoid issuing output tax invoices to hide their revenue.

¹ National Bureau of Statistics of the People's Republic of China, *China Statistical Book 2015* (China Statistics Press 2016).

² George Ding, 'How to Cheat on Taxes in China' *The New York Times* (New York, 11 September 2015) <https://www.nytimes.com/2015/09/11/opinion/how-to-cheat-on-taxes-in-china.html?_r=0> accessed 7 April 2016.

³ Lachlan Wolfers, Shirley Shen, John Wang, and Jean Li, 'Post VAT Reform in China—What's Next?' *International Tax Review* (London, 5 December 2016) <<http://www.internationaltaxreview.com/Article/3644766/Post-VAT-reform-in-Chinawhats-next.html>> accessed 7 October 2017.

Second, they lie about the value of the input received. They either collect fraudulent input tax invoices to offset the tax charged or avoid keeping records of the input. These two strategies lead to an enormous fraudulent invoice market in China. Advertisements for unused official invoices are sent by fax, through text messages, and through street fliers.⁴ Sellers usually provide tax invoices for the business taxpayers of various sectors. This style of tax evasion is replicated in millions of companies across China. The text below is an example of an advertisement for fraudulent invoices. More than 10 such advertisements per day are faxed to private companies.

Our company cooperates with many domestic companies [...] Now we can act for you to issue invoice with favourable price [...] ⁵ The fee of issuing VAT general invoice is 0.5 to 2 per cent of the total amount of the price, and VAT special invoice is 4 to 8 per cent [...] Authenticity is guaranteed... Cash on delivery. [Contact information was added here.] [...] Reasonable tax avoidance, Mutual corporate benefit!⁶

⁴ David Barboza, 'Coin of Realm in China Graft: Phony Receipts' *The New York Times* (New York, 3 August 2013) <<http://www.nytimes.com/2013/08/04/business/global/coin-of-realm-in-china-graft-phony-receipts.html>> accessed 7 April 2016.

⁵ It is illegal because the issuance of VAT general invoices is not based on authentic transactions between two parties.

⁶ I collected advertisements for fraudulent invoices when I was doing fieldwork during 2015 and 2016. I have retained the originals.

The China Taxation Auditing Yearbook has documented the outcome of mutual assistance, detecting fraudulent input invoices among provinces and other areas. It shows that VAT evasions are largely distributed across several coastal provinces and a few central and western provinces. Jiangsu Province had the most evasions across the country, followed by Guangdong Province and Shanghai (Figure 6). The mutual assistance of law enforcement occurred when a tax authority found one or several local companies illegally issuing or accepting VAT invoices. Such cases are often associated with hundreds of companies engaging in VAT evasions. These companies are spread across several provinces. A significant case reported by the Shanghai Audit Bureau in 2013 read:

More than 5900 companies spread in 28 provinces received over 100,000 phony VAT general invoices from the company. A total of 590 million RMB taxes were evaded...168 million of taxes, 24 million of overdue fines, and 64 million of fines were collected eventually. More than 1000 suspects were caught by the local police offices.⁷

According to an estimate from the Organization for Economic Cooperation and Development, the VAT gap in China represents around 55 per cent of all VAT revenue.⁸ Social and state observations and international calculations regarding the

⁷ See China Taxation Auditing Yearbook 2014 (China Taxation Press 2014) 335, 336.

⁸ See Jinyan Li and Wang Bin, 'Efficiency, Exports, and Evasion: Triple-E Concerns in the Chinese VAT Reform' (2005) 37 Tax Notes International 775, 788; Yan Xu, 'Putting the "Value Added" in China's VAT' (2010) 58 Tax Notes International 487, 497; Lachlan Wolfers, Shirley Shen, John Wang,

VAT gap thereby show how tax evasions are prevalent in contemporary China.

The Research Question and Principal Arguments

What explains the widespread prevalence of VAT evasion in China? What are the motivations, concerns, and opportunities that have shaped the behaviour patterns of taxpayers? Under what conditions does evasion occur? How can it be reduced?

While studies on tax evasion have predominantly focused on developed countries with established rules of law,⁹ few studies have focused on China, the world's largest authoritarian/transitional country. Some exceptions include Li and Cui,¹⁰ who argues

and Jean Li, 'Post VAT Reform in China—What's Next?' *International Tax Review* (London, 5 December 2016) <<http://www.internationaltaxreview.com/Article/3644766/Post-VAT-reform-in-Chinawhats-next.html>> accessed 7 October 2017.

⁹ See Doreen McBarnet, 'Whiter than White Collar Crime: Tax, Fraud Insurance and the Management of Stigma' (1991) 42 *British Journal of Sociology* 323, 344; Kathleen McGraw and John Scholz 'Appeals to Civic Virtue Versus Attention to Self-Interest: Effects on Tax Compliance' (1991) 25 *Law & Society Review* 471, 498; Joel Slemrod (ed), *Why People Pay Taxes: Tax Compliance and Enforcement* (University of Michigan Press 1992); John Scholz and Neil Pinney, 'Duty, Fear, and Tax Compliance: The Heuristic Basis of Citizenship Behavior' (1995) 39 *American Journal of Political Science* 490, 512; Valerie Braithwaite, 'Dancing with Tax Authorities: Motivational Postures and Non-Compliant Actions' in Valerie Braithwaite (ed), *Taxing Democracy* (Ashgate Publishing 2002) 15, 39; Joel Slemrod and Shlomo Yitzhaki 'Tax Avoidance, Evasion, and Administration' (2002) 3 *Handbook of Public Economics* 1423, 1470; James Alm, Jorge Martinez-Vazquez, and Benno Torgler (eds), *Developing Alternative Frameworks for Explaining Tax Compliance* (Routledge 2010). Bird and de Jantscher (1992)'s edited book on tax administration in developing countries was published a quarter of a century ago.

¹⁰ Wei Cui, 'Two Paths for Developing Anti-Avoidance Rules in China' (2011) 17 *Asia Pacific Tax Bulletin* 1-8; Ji Li, 'A Chinese Model for Tax Reforms in Developing Countries?' In Weitseng Chen (ed) *The Beijing Consensus? How China Has Changed the Western Ideas of Law and Economic*

that institutional building is a key for China toward effective taxation. Studying tax evasion among Chinese lawyers, van Rooij (2016) finds plural sources of perceived deterrence. They include client complaints, state authorities, and norms of law firms.¹¹ They included client complaints, state authorities, and norms of law firms. Winn and Zhang documented the Golden Tax Project in China, which, according to them, has reduced VAT fraud.¹² There have also been a few sporadic studies on regulation compliance in the context of China. For example, He used cost and benefit analysis to understand the business license compliance of migrant entrepreneurs in Beijing,¹³ and Yan et al. examined compliance with pesticide rules in rural villages.¹⁴ Given the numerous factors affecting compliance, the wide variation across industries, and the complexities of the issues at hand, these few studies suggest how little we understand this topic.

Development and Global Legal Practices (Cambridge University Press 2016).

¹¹ Benjamin Van Rooij, 'Weak Enforcement, Strong Deterrence: Dialogues with Chinese Lawyers about Tax Evasion and Compliance' (2016) 41 *Law & Social Inquiry* 288, 310.

¹² Jane Winn and Angela Zhang, 'China's Golden Tax Project: A Technological Strategy for Reducing VAT Fraud' (2013) 4 *Peking University Journal of Legal Study* 1, 33.

¹³ Xin He, 'Why Do They Not Comply with the Law? Illegality and Semi-Legality among Rural-Urban Migrant Entrepreneurs in Beijing' (2005) 39 *Law & Society Review* 527, 562.

¹⁴ Huiqi Yan, Benjamin Van Rooij, and Jeroen Van Der Heijden, 'Contextual Compliance: Situational and Subjective Cost-Benefit Decisions about Pesticides by Chinese Farmers' (2015) 37 *Law & Policy* 240, 263; Huiqi Yan, Jeroen Van der Heijden, and Benjamin Van Rooij, 'Symmetric and Asymmetric Motivations for Compliance and Violation: A Crisp Set Qualitative Comparative Analysis of Chinese Farmers' (2017) 11 *Regulation & Governance* 64, 80.

One consequence of the lack of studies on China and other authoritarian countries is that most existing regulatory frameworks and typologies are based on the experiences of liberal democratic countries. They usually neglect the specific characteristics of the regulatory problems of authoritarian regimes. At the beginning of a well-known paper, Kirchler et al. asserted:

First, the assumption that taxpayers are trying to avoid taxes whenever it pays must be doubted. Many studies show that the vast majority of citizens are willing to pay taxes. Second, most taxpayers seem to take the legitimacy of the tax system for granted. They believe in the overarching objectives of the government and pay their share without considering possibilities to avoid or to evade taxes.¹⁵

They argued that one should focus more on voluntary tax compliance instead of obliged compliance. Similarly, in her famous Compliance Model and regulatory pyramids, Braithwaite stated that ‘most of the population are assumed to be located at the base of the pyramid’,¹⁶ in which voluntary compliance is dominant. As will be shown, this assumption is questionable when it comes to taxpaying in China; the majority of business tax payers have a low level of social commitment to paying tax. Most have little respect for the law and do not trust the tax authorities. They often

¹⁵ Erich Kirchler, Erik Hoelzl, and Ingrid Wahl, ‘Enforced Versus Voluntary Tax Compliance: The ‘Slippery Slope’ Framework’ (2008) 29 *Journal of Economic Psychology* 210, 225.

¹⁶ Valerie Braithwaite, ‘Dancing with Tax Authorities: Motivational Postures and Non-Compliant Actions’ in Valerie Braithwaite (ed), *Taxing Democracy* (Ashgate Publishing 2002) 5.

choose to evade tax as soon as an opportunity is presented to them. The main characterizations of regulatory capitalism, such as the responsibility of businesses and the decentralization of regulation away from the state, are not applicable in China.¹⁷

To understand the situation in China, one should thus forsake such an assumption and start from square one: What factors shape taxpaying behavior? How does the lower level of legitimacy or trust factor into the calculations? Over the last three decades, one consensus of regulatory studies may be that there is no single factor that can explain the patterns of compliance.¹⁸ Referring back to authoritarian regimes such as China helps obtain a more comprehensive picture of this issue. Studying a country where the rule of law is still developing while the market economy is far from mature allows us to observe a more complete spectrum of factors and their interactions in shaping compliance.

¹⁷ Christine Parker and Vibeke Nielsen, 'The Challenge of Empirical Research on Business Compliance in Regulatory Capitalism' (2009) 5 Annual Review of Law and Social Science 45, 70.

¹⁸ Lawrence Friedman, *Impact: How Law Affects Behavior* (Harvard University Press 2016); Christine Parker and Vibeke Nielsen, 'Mixed Motives: Economic, Social, and Normative Motivations in Business Compliance' (2012) 34 Law & Policy 428,462.

Setting the Theoretical Framework of Compliance

The field of empirical research on business compliance is rich, diverse, and still ripe for theoretical development.¹⁹ There are multiple frameworks to explain compliance (Table 1), with two main branches of compliance theory.

One strand of socio-legal literature on compliance focuses on structural reasons; legal designs and implementations impact compliance.²⁰ Many earlier studies have focused on fear of detection and punishment.²¹ Some areas are heavily regulated by laws and compliance has been achieved – the safety of dairy and meat products,²² underground coal mining,²³ cigarette-smoking in workplaces and

¹⁹ Christine Parker and Vibeke Nielsen, 'Introduction' in Christine Parker and Vibeke Nielsen (eds), *Explaining Compliance: Business Responses to Regulation* (Edward Elgar Publishing 2011) 1, 36.

²⁰ Christine Parker and Vibeke Nielsen, 'Introduction' in Christine Parker and Vibeke Nielsen (eds), *Explaining Compliance: Business Responses to Regulation* (Edward Elgar Publishing 2011) 1, 36; Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press 1995).

²¹ Michael Allingham and Agnar Sandmo, 'Income Tax Evasion: A Theoretical Analysis' (1972) 1 *Journal of Public Economics* 323, 338.

²² Eugene Bardach and Robert Kagan, *Going by the Book: The Problem of Regulatory Unreasonableness* (Transaction Publishers 2002).

²³ Michael Lewis-Beck and John Alford, 'Can Government Regulate Safety? The Coal Mine Example' (1980) 74 *American Political Science Review* 745, 756.

restaurants,²⁴ and air and water pollution,²⁵ to name a few examples. Other areas are less regulated, such as the trucking industry.²⁶ In their study of nursing homes, Makkai and Braithwaite found that, once illegitimate opportunities are blocked, a significant effect on regulatory compliance occurs.²⁷ Moreover, ‘the structural characteristics of an economic or social situation provide an opportunity for an individual to engage in deviant behavior and avoid detection’.²⁸ The more illegitimate opportunities there are in a given social network, the more likely taxpayers are to cheat on taxes.²⁹ For example, self-employed businesses are the least compliant taxpayers, according to IRS estimations. Those in the finance, real estate, and insurance industries, who have taxes withheld by a third party, are more likely to

²⁴ Robert Kagan and Jerome Skolnick, ‘Banning Smoking: Compliance without Enforcement’ in Robert Rabin and Stephen Sugarman (eds), *Smoking Policy: Law, Politics, and Culture* (Oxford University Press 1993) 69, 94.

²⁵ Lyle Scruggs, ‘Institutions and Environmental Performance in Seventeen Western Democracies’ (1999) 29 *British Journal of Political Science* 1, 31.

²⁶ Dorothy Thornton, Robert Kagan, and Neil Gunningham, ‘When Social Norms and Pressures are Not Enough: Environmental Performance in the Trucking Industry’ (2009) 43 *Law & Society Review* 405, 436.

²⁷ Toni Makkai and John Braithwaite, ‘Criminological Theories and Regulatory Compliance’ (1991) 29 *Criminology* 191, 220.

²⁸ Loretta Stalans, Kent Smith, and Karyl Kinsey, ‘When Do We Think About Detection? Structural Opportunity and Taxpaying Behavior’ (1989) 14 *Law & Social Inquiry* 481, 503.

²⁹ Kent Smith and Karyl Kinsey, ‘Understanding Taxpaying Behavior: A Conceptual Framework with Implications for Research’ (1987) 21 *Law & Society Review* 639, 663; Bernadette Kamleitner, Korunka Korunka and Erich Kirchler ‘Tax Compliance of Small Business Owners: A Review’ (2012) 18 *International Journal of Entrepreneurial Behaviour & Research* 330, 351.

comply.³⁰ Taxpayers' positions in a supply chain decide the extent to which they are able to cooperate with the other party on both the supply and demand sides to evade taxes. The size of firms, their organizational capacities and characteristics, the nature of businesses, and market niches are also structural factors that may shape the scale of illegitimate activities.³¹ Stalans et al. suggested that individuals with high levels of structural opportunities perceived lower levels of possibility of detection and less severe sanctions. It thus bridges the study of deterrence and opportunity.³²

Structural reasons, however, are not adequate to explain compliance. Another strand of scholarship focuses on social norms; studies have found that compliance can come from social pressure.³³ Many businesses fear the adverse publicity that can arise from regulatory violations. Adverse publicity can trigger negative reactions from the community. Those negative reactions, in turn, can result in financial losses and tarnish the reputation of the company and its individual managers. Moreover, compliance is

³⁰ Leandra Lederman, 'The Interplay between Norms and Enforcement in Tax Compliance' (2003) 64 Ohio State Law Journal 1453, 1514; Susan Morse, Stewart Karlinsky and Joseph Bankman, 'Cash Businesses and Tax Evasion' (2009) 20 Stanford Law & Policy Review 37, 68.

³¹ Dorothy Thornton, Robert Kagan, and Neil Gunningham, 'When Social Norms and Pressures are Not Enough: Environmental Performance in the Trucking Industry' (2009) 43 Law & Society Review 405, 436; Christine Parker and Vibeke Nielsen, 'Introduction' in Christine Parker and Vibeke Nielsen (eds), *Explaining Compliance: Business Responses to Regulation* (Edward Elgar Publishing 2011) 1, 36.

³² Loretta Stalans, Kent Smith and Karyl Kinsey, 'When Do We Think About Detection? Structural Opportunity and Taxpaying Behavior' (1989) 14 Law & Social Inquiry 481, 503.

³³ Loretta Stalans, Kent Smith, and Karyl Kinsey, 'When Do We Think About Detection? Structural Opportunity and Taxpaying Behavior' (1989) 14 Law & Social Inquiry 481, 503.

motivated by various degrees of intensity of internalized social norms. People feel obligated to comply with the law because the law entails legitimacy and authority.³⁴ This legitimacy theory implies that perceived trust and procedural justice lead to voluntary compliance. The slippery slope model suggests that authorities' position toward taxpayers is relevant to compliance; an antagonistic tax climate will have a different level of compliance than a synergistic tax climate.³⁵ Some people also comply as fully as possible with aspirational standards, such as environmental protection or concern for human health.³⁶ Further efforts have tried to provide detailed classifications of social norms, in order to understand their impact on compliance. Vandenberg, for example, distinguished social norms into procedural and substantive norms.³⁷ Cullis et al. distinguished between the *prevalence* of the social norm (the proportion of people who actually pay their taxes honestly) and the *strength*

³⁴ Tom Tyler, *Why People Obey the Law* (Yale University Press 1990)); Tom Tyler, 'The Psychology of Self-Regulation: Normative Motivations for Compliance' in Christine Parker and Vibeke Nielsen (eds), *Explaining Compliance: Business Responses to Regulation* (Edward Elgar Publishing 2011) 78, 99.

³⁵ Erich Kirchler, Erik Hoelzl and Ingrid Wahl, 'Enforced Versus Voluntary Tax Compliance: The 'Slippery Slope' Framework' (2008) 29 *Journal of Economic Psychology* 211, 225.

³⁶ Peter May, 'Regulation and Compliance Motivations: Examining Different Approaches' (2005) 65 *Public Administration Review* 31, 44; Dorothy Thornton, Neil Gunningham, and Robert Kagan, 'General Deterrence and Corporate Environmental Behavior' (2005) 27 *Law & Policy* 262, 288.

³⁷ Michael Vandenberg, 'Beyond Elegance: A Testable Typology of Social Norms in Corporate Environmental Compliance' (2003) 22 *Stanford Environmental Law Journal* 55, 144.

of the norm (the proportion of individuals who think that they ought to pay taxes, whether they actually do so or not).³⁸

The structural opportunity to evade tax incorporates social, economic, and institutional characteristics of actors and subjective deterrence. The social norm of compliance considers the interactions among taxpayers and the reciprocity of the state and taxpayers.³⁹ This study argues that the two factors work together to shape tax compliance behavior in southeast China.

³⁸ John Cullis, Philip Jones, and Alan Lewis, 'Tax Compliance: Social Norms, Culture, and Endogeneity' in James Alm, Jorge Martinez Vazquez, and Benno Torgler (eds), *Developing Alternative Frameworks for Explaining Tax Compliance* (Routledge 2010) 35, 55.

³⁹ Eric Posner, 'Law and Social Norms: The Case of Tax Compliance' (2000) 86 *Virginia Law Review* 1781, 1819.

Table 1. Plural Frameworks through which to Explain Compliance

Authors	Year	Context	Level	Framework	Descriptions
Kagan and Scholz	1984	General	Firm	Economic calculation	Profit-seeking
				Principled disagreement	Belief in the rule of law
				Organizational failure	Knowledge and capacity to obey
Tyler	1990	Court and Police	Individual	Instrumental	Deterrence and self-interest
				Normative	Legitimacy, morality
Nagin and Paternoster	1993	Criminology	Individual	Propensity	Self-control
				Opportunity	Routine activity and rational choice
Thornton, Kagan, Gunningham	2003, 2004, 2009, 2011	Environment	Firm	Legal license	Applicable laws, regulations, and permit conditions
				Social license	Social pressures from the media, advocacy groups, friends and family, etc.
				Economic license	The general market, the market niche and financial condition
Kirchler et al.	2008	Tax	Individual community	Power	Tax audits and punishment
				Trust	Belief in tax authorities
Braithwaite	2009	Tax	Individual	Commitment	Moral support for tax authorities
				Capitulation	Recognizing the tax authority's power and endorsing a ritualistic "keep them happy" philosophy
				Resistance	Opposing tax authority and accusing it of abuse of power
				Disengagement	Ignoring tax authority demands and threats
				Game playing	Enjoying tax-minimizing games with tax officials
Gezelius and Hauck	2011	Fisheries	Community	Deterrence	Cost and benefit calculations
				Moral support for the law's content	Fishers perceive that rules and regulations correspond to their moral beliefs
				Legislative authority	Moral obligation to obey the law even if they disagree with the law's content
Nielsen and Parker	2012	General	Firm	Economic motive	Calculative thinking
				Social motives	Significant others
				Normative motives	Internalized moral judgments by people about the substance and procedures of regulation

Definitions of VAT Compliance in this Study

This study measures behavioral compliance, instead of psychological compliance (attitudes of commitment or resistance).⁴⁰ As Parker and Nielsen put it:

Measuring a firm's attitudes and motivations about compliance is not the same as measuring compliance behavior, and a positive attitude or motivation may not lead to matching behavior.

To assess compliance levels, I need to establish substantive evaluation criteria espoused by taxpayers or tax authorities. Since VAT is based on the difference between input and output values, business taxpayers are required to honestly issue output invoices and receive input invoices. All information should be kept in their accounting books. Therefore, honestly issuing output invoices and keeping input invoices are two significant regulatory requirements for VAT payment. I asked taxpayers how often they issued output invoices to their clients genuinely and how often they kept input invoices honestly. Four scales including "always do", "often do", "rarely do", and "never do" were provided. Their average scores from the two questions were then used to measure compliance levels. I also asked taxpayers to tell me the turnover they reported and the authentic turnover they actually achieved. This

⁴⁰ Kristina Murphy, 'Regulating More Effectively: The Relationship between Procedural Justice, Legitimacy, and Tax Non-Compliance' (2005) 32 *Journal of Law and Society* 562, 589; Valerie Braithwaite, 'Dancing with Tax Authorities: Motivational Postures and Non-Compliant Actions' in Valerie Braithwaite (ed), *Taxing Democracy* (Ashgate Publishing 2002) 15, 39.

study only focuses on taxpayers formally conducting their businesses. The shell companies that are set up to gain profits by selling fraudulent invoices are excluded.

Data and Methodology

This study draws on published resources in English and in Chinese, official statistics, and in-depth, ethnographic observations regarding business responses to tax laws and frontline tax officials' decisions about law enforcement. Openly available materials include national, provincial, municipal, and county-level tax yearbooks and statistical yearbooks, local official tax periodicals, and tax-related judicial verdicts. My most valuable sources of information were taken from observations of business taxpayers and frontline tax bureaus in southeast China during 2015 and 2016.

The Location of My Fieldwork

I conducted my fieldwork in three southeastern cities in Fujian Province (Figure 6). The three cities covered an area of 15,308 square kilometers with a population of 10.95 million in 2016. The annual GDP of the three cities totaled 875 billion RMB and the per-capita GDP was 77,808 on average in 2016. The three cities are geographically connected to each other. I chose them as my fieldwork sites both because I was born here and because this area has higher rates of VAT evasion, compared with other places around China. As a local, it was easy for me to access informants by speaking the local dialect and making use of my existing social connections. The auditing data from 2009 to 2014 show that there were prevalent

rates of VAT evasion in this area. Studying tax compliance here helps us to pierce the veil of tax evasions across the country.

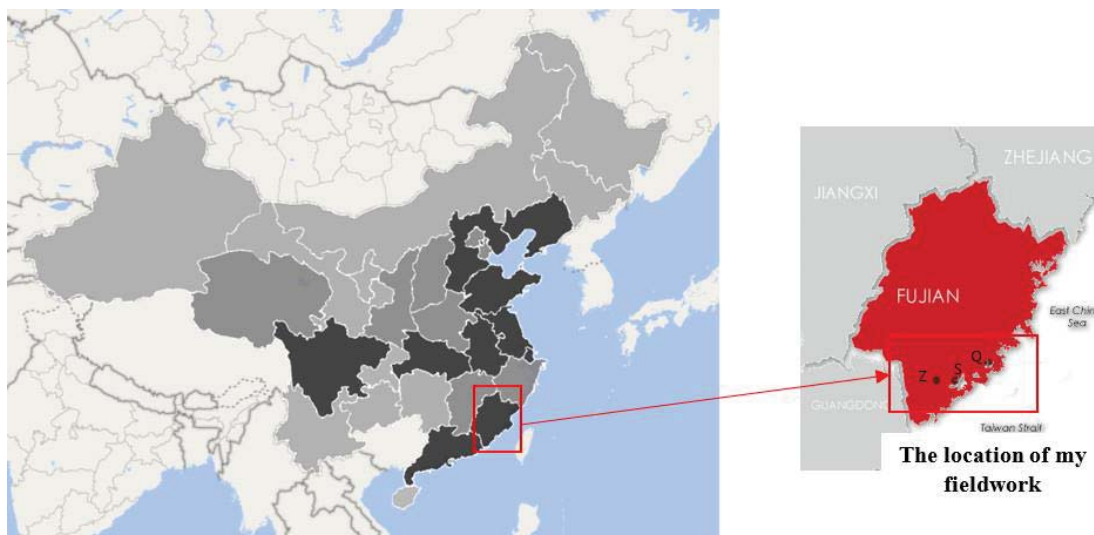


Figure 6. The Location of My Fieldwork ⁴¹

The Major Sources of Data

The first major source of my data was complemented by interviews with 65 private business taxpayers from the shoe industry and other industries from City Q and City S during 2015 and 2016. I also interviewed 12 private businesses in City Z

⁴¹ The distributions of the invoice violations are based on the data from the auditing yearbooks from 2010 to 2015. See SAT Auditing Bureau, *China Taxation Auditing Yearbook (2010-2015)* (China Tax Press). The yearbook released the outcome of investigations of fraudulent VAT invoices under the Invoice Checking Assistance Sub-System, which is a mutual assistance system used to detect fraudulent VAT invoices in every province and municipality governed directly by the central government. I calculated the sum of taxes, fines, and overdue fines from 2009-2014 in every place and grouped them into three levels. Though the data cannot cover all the VAT invoice violations in China, they give a picture of a rough distribution around the country.

when I carried out preliminary fieldwork in 2014. The findings of this study will be based on the 65 private businesspeople I interviewed in City Q and City S.

City Q, a county-level municipality that is governed directly by province-level divisions is a pioneer in the Chinese shoe manufacturing industry. Since the Economic Reforms were initiated in the late 1970s, City Q has enjoyed rapid economic development. Ranked the 8th richest town in China in 2016, its GDP at the time was 162.04 billion RMB, accounting for 26.4 per cent of the GDP of the municipality and 6.2 per cent of the GDP of the province; its fiscal income was 12.03 billion. As one of the three pillar industries in City Q, the sports shoes manufacturing industry's annual revenue in 2016 was 106 billion, accounting for 40 per cent of national production and 20 per cent of global production. Known as "The City of Shoes", City Q had 3,388 shoe-related companies in 2013. Of these, 237 companies had annual revenues of over 20 million, 158 over 100 million, and five over 500 million. A total of 22 were listed and traded on the stock market. City Q is a close-knit community where people speak the same dialect and share the same traditional culture.

As a sub-provincial city and one of the original four special economic zones opened to foreign investment and trade in the early 1980s, City S enjoys a diverse and well-developed economy. It is divided into six districts. Altogether, these cover an area of 1,699 square kilometers with a population of 3.92 million, as of 2016. Due to its special political status, the government enjoys much greater autonomy than any

other cities in the province. City S always becomes the pilot of tax reforms in all respects.

In total, I interviewed 35 shoe companies spread across 12 villages in City Q and 30 businesses across five districts of City S. Of all the shoe companies I interviewed in City Q, 25 were shoe manufacturers, four were shoe materials manufacturers, and six were shoe materials wholesalers. The respondents of City S include 15 moulds (machine or hardware) manufacturers and wholesalers, five paper and packaging traders and manufacturers, four electronic component manufacturers, two construction companies, one billboard designer, one business cards manufacturer, one sunglasses wholesalers, and one sports goods manufacturer.

Table 2 lists the characteristics of the 68 respondents,⁴² including age, gender, educational background, origin, and position. The distributions of the seven items were similar in the two cities. There are three major differences. First, 32 out of 36 respondents (88.89 per cent) were local in City Q, while only two out of 30 respondents were local in City S (6.67 per cent). Second, the respondents from City S were more educated, with 43 per cent (13 out of 30) holding above a college degree, compared with 22.22 per cent (eight out of 36) in City Q. Finally, City Q had nine minority respondents, while City S had only three.⁴³

⁴² I interviewed two informants in Norkey (Q33): the owner (Q33A) and the financial manager (Q33B). I also interviewed a tax specialist, Ms. Huang (Q36), in City Q, and Mr. Zhu (S31), who is a part-time tax preparer of the 30 companies that I interviewed in City S.

⁴³ There was a Hui Minority community in City Q. Many owners of large or listed companies were Hui

Table 2. Overview of the Business Informants

Age		Gender		Education Level		Origin	
≤20	0/0	male	26/21	Primary school	1/1	Local	33/2
21-30	3/3	female	11/10	Junior high school	13/8	Non-local	3/29
31-40	15/15			Senior high school	10/9	Unknown	1/0
41-50	15/12			College (大專)	4/8		
51-60	3/1			Bachelor's degree	4/4		
≥61	1/0			Master's degree	0/1		
				Unknown	5/0		
Communist Party Member		Ethnicity		Religion		Position	
Yes	5/0	Han (majority)	22/28	Yes	2/5	Owner	21/20
No	27/31	Minority	9/3	No	24/24	Financial manager/tax preparer	16/11
Unknown	5/0			Unknown	11/2		

Note: The values to the left of the slashes refer to City Q, while those to the right refer to City S.

The second source of data was complemented by interviews with 34 tax officials in County J of City Z, which is connected to City Q and City S. In 2015, the county's gross domestic product per capita reached 25.7 billion RMB, compared with 162 billion in the strongest county of the province (ranked No. 5 in the country)⁴⁴ and 4.2 billion in the poorest county of the province.⁴⁵ It covers an area of 2,100 square kilometres, with a population of 0.86 million and 16 towns.⁴⁶ The county is noted for its chemical, agriculture, and tourism industries.

Bureau P administered VAT, while Bureau R collected business tax. On 1 May 2016, China initiated a VAT reform to replace business tax with VAT. My interview

people.

⁴⁴ China Top 100 Counties Yearbook 2015.

⁴⁵ Provincial Statistical Yearbooks 2016.

⁴⁶ The County Government Annual Working Report 2016.

with the local tax bureau, however, is not meaningless. It is helpful to have a full understanding of tax administration and law enforcement in China.

In Bureau P, there are eight departments, including departments of personnel and education, supervision, financial management, tax policy, administration of tax collection, tax payment services, information management, income accounting, an audit bureau, a general office, and six tax branches. The six branches administer different types of taxpayers. Regarding the sectors, the first branch takes charge of larger businesses (including the financial and insurance sector); the second branch collects taxes from export enterprises and overseas-funded enterprises; the third branch manages the taxes from the stone materials industry and gas stations; and the fourth, fifth, and sixth branches deal with smaller sized enterprises that pay less than 1 million annually. With respect to the size of the businesses, the first and second branches administer large businesses (which pay more than 1 million per year), while the remaining two branches manage all small and medium sized enterprises and individually-owned businesses. In total, 102 staff members were working for Bureau P at the time of this study. In order to make paying tax easier, the sixth and seventh branches are located in different places to Bureau P.

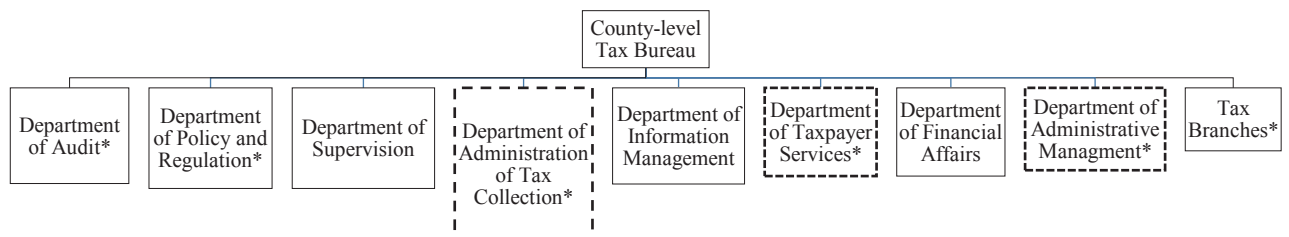


Figure 7. The Organizations of the County-Level Tax Bureau

Notes: The departments marked with an asterisk (*) were interviewed; the three dotted boxes were the departments held by Bureau R.

Bureau R belongs to the local taxation system. It was established in July 2012, to collect taxes from a new harbour development zone (海港開發區). Bureau R's administrative level is the same as Bureau P's. Bureau R directly reports to the local city tax bureau. Bureau R has three major departments, including a general office, a tax service hall, and tax administration office, with a total of 16 tax officials.

Table 3 shows the number of interviews conducted in Bureau P and Bureau R. Some interviews were conducted in their offices. In a couple of instances, I asked the interviewees questions when they were dealing with particular cases outside the tax bureaus or when we were having a meal or tea together.

Table 3. The Profile of Informants in County J, City Z (2015-2016)

Gender	Age	Service years	CPC member	Home origin	Degree	Bureau							
Male	29	≤30	7	≤5	7	Yes	32	Local	32	High school	0	State	21
Female	5	31-40	10	6-10	6	No	2	Non-local	2	College	6	Local	13
		41-50	9	11-15	1	Bachelor's	25						
		>51	8	16-20	3	Master's	3						
			>21	17									
Total	34		34		34		34		34		34		34

The Methods of Collecting Data

As noted by Parker and Nielsen, gaining access to relevant data on compliance is difficult. Much information about compliance is internal to the businesses themselves and it will often not be in their best interests to open up their responses to regulations to external researchers. Even if they are eventually willing to share some information,

it has to be filtered, and is thus biased.⁴⁷ Furthermore, if this is the case in democratic countries, obtaining data on compliance is even more difficult in China, where many companies are, to some extent, involved in tax evasion. Both business managers and tax officials are thus wary of any inquiry from researchers. This also explains the paucity of research in this area and why the scant amount of studies in the existing literature rely primarily on laws and regulations, published documents, and news reports. According to Parker and Nielsen, two problems of validity are critical in regard to collecting and analyzing business compliance data: the biased data source problem and the shaky information problem.⁴⁸ I adopted an unconventional method to overcome these challenges. Through personal connections, several bank managers from three branches located in City Q provided personal assistance. Since the bank managers had close relations with the business owners and financial managers, with their presence, it was easier to gain the trust of the businesses. In City S, an owner of an accounting firm, which had helped more than 200 companies to deal with tax issues, introduced me to his clients during his monthly visits. Due to this special connection, respondents were willing to share their experiences with tax authorities and their opinions about VAT payment with me.

⁴⁷ Christine Parker and Vibeke Nielsen, 'Introduction' in Christine Parker and Vibeke Nielsen (eds), *Explaining Compliance: Business Responses to Regulation* (Edward Elgar Publishing 2011) 1, 36.

⁴⁸ Christine Parker and Vibeke Nielsen, 'The Challenge of Empirical Research on Business Compliance in Regulatory Capitalism' (2009) 5 *Annual Review of Law and Social Science* 45, 70.

During my fieldwork, I stressed that my research was anonymous, and that any details that could reveal the identity of the informants would be removed. The conversations normally began with how they had started their businesses, what difficulties they had encountered, and the business environment. Then, I asked them to evaluate the tax system, tax burden, and tax authorities. I talked about their practices and strategies in regard to evading or avoiding taxes. They called these strategies “open secrets” in the industry. Then, they were asked to complete the questionnaires. Overall, the informants were frank and shared with me their attitudes and practices in regard to paying tax. As will be shown, many of them told me that they had evaded tax, exactly how much their annual revenues were, and how much tax had been evaded. Some of them even provided me with their internal annual reports. I believe that the data collected are trustworthy for the purposes of my analysis.

In total, I conducted 68 interviews in the two cities. Each interview lasted at least one hour. A total of 15 respondents were interviewed more than twice, either through phone calls or face-to-face. I collected 24 (response rate: 68.57 per cent) and 30 (response rate: 100 per cent) questionnaires from City Q and City S, respectively. Even though the survey response rate is lower in City Q, I obtained their opinions on the procedures that tax officials used and on tax systems themselves. None of the interviews were taped. Instead, I took detailed notes immediately after conducting each interview.

I was officially approved to examine one county-level state tax bureau (Bureau P) and one county-level local tax bureau (Bureau R). Living in the dormitories of the two tax offices for one month enabled me to conduct detailed interviews with and acquire comprehensive data from tax officials to local corporate taxpayers, and from frontline tax branches to city-level offices. My method was to develop a rapport that allowed in-depth interviews to be conducted with those who had knowledge of the tax administration. My questions focused on what their major concerns in their everyday work were. I explored the resources they controlled, the internal and external restrictions they had, and how they solved problems. I collected specific cases and statistical information that could lend insight into the logic of their behaviour.

Organization of this Dissertation

Chapter One of the dissertation examines whether or not and how the three VAT reforms have influenced tax compliance in the last three decades. It suggests that overall VAT compliance has improved gradually because the opportunity to evade tax has been reduced and the social norms of compliance have been promoted. The VAT reforms, however, have limitations. The current technology-based administration remains ineffective in regard to taxpayers who involve in shadow economy. It is still difficult to say that Chinese taxpayers are more willing to pay taxes because of high levels of tax burden, weak exchange norms between the government and taxpayers, and weak vertical norms emerging from the uneven distributions of social and political resources.

Chapter Two presents the decisions made regarding everyday practices in frontline tax authorities. Drawing on cost-benefit analysis, the chapter finds four types of decisions in these situations: symbolic enforcement, creative enforcement, weak enforcement, and negotiated enforcement. It reveals the limited institutional motivations and weak capacity of tax authorities to deter tax evasions effectively. This pattern of decision-making can be used to organize previous studies on law enforcement in China.

Chapter Three examines how social and institutional opportunities interact. It shows two types of opportunities to evade in the Chinese market. The first category of taxpayers, who had greater opportunities to evade tax due to two strokes of good luck (i.e., high social and high institutional opportunities). The second category of taxpayers suffered from both lower social and institutional opportunities to evade tax. This explains the divergent structural opportunities to evade tax in contemporary China.

Chapters Four and Five shift focus to another factor of tax compliance: social norms encouraging compliance. Chapter Four tests whether or not procedural norms matter in the Chinese tax context. Surprisingly, the results show that procedural norms have trivial effects on enhancing tax compliance in China. They also fail to provide a cushion of support when other variables are disfavoured. I speculate that a lack of social identity could be used to explain the small effects of procedural norms on enhancing tax compliance in China.

Chapter Five explains why people are unwilling to pay taxes. I argue that substantive norms, composed of individual, horizontal, vertical, and exchange norms, play roles in undermining the legitimacy of VAT law. This chapter also finds that individual norms are the most important in understanding the unwillingness of Chinese businesses to pay taxes.

Chapter Six studies how the two dimensions of tax compliance (social opportunities to evade and social norms to comply) work together to shape business compliance decisions. A two-by-two matrix is used to understand the following types of behaviour: aggressive evasion, obliged compliance, strategic compliance, and voluntary compliance.

Chapter Seven generalizes the applications of the typology based on the Chinese tax context. This framework can be used to organize previous research on compliance in tax contexts, as well as other regulatory contexts. A two-pronged regulatory strategy, which suggests that only when the opportunity to evade tax and social norms were improved together can the overall compliance level be substantially enhanced, is proposed to improve compliance in China and other countries. It concludes with some limitations of the study and possible research that could be carried out in the future.

Chapter One. Tax Reforms and Tax Compliance in China

Did Tax Reforms Improve Tax Compliance in China?

China has experienced three tax reforms in the last three decades. The first reform was called the tax contract system, known as “eating from separate pots” (分灶吃飯), in which provinces and the centre shared total tax revenues.⁴⁹ Then came the “division of taxes” (分稅制) reform in 1994. China formally introduced the “VAT family”,⁵⁰ consisting of VAT, which applies to goods and some services; business tax (BT), which applies to most services; and consumption tax, which applies to luxury goods.⁵¹ The latest VAT reform, calling ‘to replace the BT with VAT’ (營業稅改征

⁴⁹ Elizabeth Remick, *Building Local States: China during the Republican and Post-Mao Eras* (Harvard University Press 2004) 142.

⁵⁰ See Yan Xu, ‘Putting the “Value Added” in China’s VAT’ (2010) 58 *Tax Notes International* 487, 497. She suggests that China’s VAT system is a combination of VAT, BT and consumption tax. VAT is the head of the ‘family’ and ‘compared with a classical VAT, Chinese VAT can be described as impure’. This study incorporates VAT, BT and consumption tax into the VAT system.

⁵¹ The differences between VAT, BT and consumption tax, *inter alia*, are as follows: (1) VAT is imposed on the taxpayers who are ‘engaged in the sales of goods, provision of processing, repairs and replacement services, and the importation of goods’ (Article 1). See Provisional Regulations of the PRC on VAT (中華人民共和國增值稅暫行條例) (13 December 1993). The revised version was enforced on 1 January 2009. (2) BT is levied on taxpayers who are ‘engaged in the provision of services...the transfer of intangible assets or the sale of immovable properties’ (Article 1). See Provisional Regulations of the PRC on BT (中華人民共和國營業稅暫行條例) (13 December 1993). The revised version was enforced on 1 January 2009. It was abolished on 30 October 2017. (3) Consumption tax is imposed on luxury goods such as cigarettes, wine and expensive jewellery (Article 1). The amount payable is calculated by applying the *ad valorem* or specific tax methods, or a

增值稅), started in 2012 and finished in 2016.⁵² Did these tax reforms promote tax compliance in China? If yes, how did they work? Of course, improving taxpayer compliance was not a key goal of tax reform, but different features of the tax law and regulations are relative to theoretical concepts of tax compliance studies.⁵³

Only a few studies show the relationship between existing tax reforms and tax compliance in China. Some found that the Chinese VAT system has several inadequacies, *inter alia*, as follows: (1) it is incomplete and not neutral because it excludes the service sector;⁵⁴ (2) there is widespread evasion through forged or fraudulent invoices;⁵⁵ (3) administration is poor for reasons including corruption,

composite of the two. See Provisional Regulations of the PRC on Consumption Tax (2008 Revision) (中華人民共和國消費稅暫行例) (13 December 1993). The revised version was enforced on 1 January 2009.

⁵² Ministry of Finance and SAT, ‘Yingyeshui gai zengzhishui shidian fang’an’ [The Pilot Proposal on Replacing BT with VAT] (16 November 2011) <http://szs.mof.gov.cn/zhengwuxinxi/zhengcefabu/201111/t20111117_608456.html> accessed 9 December 2015.

⁵³ ⁵³ Karyl Kinsey and Howard Grasmick, ‘Did the Tax Reform Act of 1986 Improve Compliance? Three Studies of Pre- and Post- TRA Compliance Attitudes’ (1993) 15 *Law & Policy* 239, 325.

⁵⁴ See Bin Yang, ‘Xianxing zengzhishui de zhidu zhang’ai, guanli wuxiaoxing he zhongguoshi zengzhishui de zhidu sheji’ [The Institutional Impediment and Administrative Inefficiency of China’s VAT System and the Design for a New Chinese-Characteristic of VAT Regime] (2001) 2 *Caizheng Yanjiu* (Public Finance Study) 52, 57; Richard Bird and Gendron Pierre-Pascal, *The VAT in Developing and Transitional Countries* (Cambridge University Press 2007) 164, 165; Yan Xu, ‘Reforming Value Added Tax in Mainland China: A Comparison with the EU’ (2011) 20 *Revenue Law Journal* 1, 31.

⁵⁵ See Yan Xu, ‘Putting the “Value Added” in China’s VAT’ (2010) 58 *Tax Notes International* 487, 497; Jinyan Li and Wang Bin, ‘Efficiency, Exports, and Evasion: Triple-E Concerns in the Chinese VAT Reform’ (2005) 37 *Tax Notes International* 775, 788.

inefficiency and inaccuracy in collection, refund and audit.⁵⁶ This strand of studies viewed tax evasions as one inadequacy of the VAT system. It focused less on the linkage between tax reforms and tax compliance.

Winn and Zhang examined the latest technological upgrades of e-invoices in China and suggested that the Chinese Golden Tax Project (GTP, 金税工程) might provide a viable model for developing countries looking to improve VAT compliance. Moreover, unlike America and the members of the European Union whose business cultures support self-assessment and allow enterprises to voluntarily adopt e-invoicing technology, China requires more and stronger central controls and more stringent policies to promote voluntary VAT compliance.⁵⁷ The study presented a positive tone about tax reforms. However, it only considered how the second tax reform reduced the opportunity to evade.

Borrowed from Kinsey and Grasmick's study, this chapter incorporates two dimensions to evaluate the three tax reforms in the last three decades:⁵⁸ structural opportunities to evade and social norms to comply.⁵⁹ The difference from Kinsey and

⁵⁶ See Yan Xu, 'Putting the "Value Added" in China's VAT' (2010) 58 *Tax Notes International* 487, 497.

⁵⁷ Jane Winn and Angela Zhang, 'China's Golden Tax Project: A Technological Strategy for Reducing VAT Fraud' (2013) 4 *Peking University Journal of Legal Study* 1, 33.

⁵⁸ Karyl Kinsey and Howard Grasmick, 'Did the Tax Reform Act of 1986 Improve Compliance? Three Studies of Pre- and Post- TRA Compliance Attitudes' (1993) 15 *Law & Policy* 239, 325.

⁵⁹ The dimension of self-interest, which refers to the effects of tax rates on compliance, can be included in social norms.

Grasmick's study is that I do not examine taxpayers' subjective attitudes. Instead, I analyse the objective effects of the two dimensions under every tax reform in China. This chapter evaluates the impacts of three tax reforms on tax compliance in the last three decades.⁶⁰ Drawing on historical documents, laws and regulations, and several types of statistical yearbooks published in China, the rest of the chapter will review the reform strategies and evaluate their impacts on tax compliance.

The Experiment Period (1979–1993)

Decentralized VAT Administration

The major objectives of fiscal reform, which began in the early 1980s, were to make local governments fiscally self-sufficient and to encourage localities to promote economic development.⁶¹ In the bottom-up revenue-sharing system, localities not only had responsibility for and rights over local expenditure, but they also enjoyed five-year central-local fiscal contracts that allowed them to submit only a proportion of their revenue to higher level governments and keep most of the remainder.⁶² The

⁶⁰ Karyl Kinsey and Howard Grasmick, 'Did the Tax Reform Act of 1986 Improve Compliance? Three Studies of Pre- and Post- TRA Compliance Attitudes' (1993) 15 *Law & Policy* 239, 325.

⁶¹ Jean Oi, 'Fiscal Reform and the Economic Foundations of Local State Corporatism in China' (1992) 45 *World Politics* 99, 126.

⁶² Hehui Jin, Yingyi Qian and Barry Weingast, 'Regional Decentralization and Fiscal Incentives: Federalism, Chinese Style' (2005) 89 *Journal of Public Economics* 1719, 1742.

sharing ratio varied from province to province.⁶³ The fiscal contract system thus gave local government an incentive to increase revenues and engage in economic reform.

Since 1984, state-owned enterprises (SOEs) have paid income taxes to the government instead of remitting all the profits.⁶⁴ When Industrial and Commercial Tax (工商業稅) was split into smaller components (VAT, BT and product tax) in the early 1980s,⁶⁵ China initially introduced VAT in only two industries (machinery and agricultural tools) and three products (bicycles, sewing machines and electric fans) in several important cities (e.g., Shanghai and Xi'an).⁶⁶ In 1984, VAT was gradually applied across the country, but a lack of standardization remained.⁶⁷ Individual income tax was also launched in 1980.⁶⁸ These changes imposed greater challenges

⁶³ For example, the shares for Beijing, Tianjin, Shanghai, Hebei and Shanxi were 49.55 per cent, 39.45 per cent, 23.54 per cent, 69.1 per cent and 97.5 per cent, respectively. Chien-Hsun Chen and Hsiu-Ling Wu, 'Fiscal Structures and Regional Economic Growth: Evidence from China's Fiscal Contract System' (2008) *The Journal of Developing Areas* 119, 135.

⁶⁴ Elizabeth Remick, *Building Local States: China during the Republican and Post-Mao Eras* (Harvard University Press 2004) 146.

⁶⁵ Industrial and commercial tax is one of the earliest taxes in China. Industrial and commercial entrepreneurs should pay business tax and income taxes. See Provisional Regulations of Industrial and Commercial Tax (工商業稅暫行條例) (30 January 1950).

⁶⁶ Yan Xu, 'A Historical Account of Taxes on Goods and Services in the Transition to Post-Socialist China' in Peter Harris and Dominic de Cogan (eds), *Studies in The History of Tax Law* (Volume 7, Hart Publishing 2015) 393, 420.

⁶⁷ Richard Bird and Gendron Pierre-Pascal, *VAT in Developing and Transitional Countries* (Cambridge University Press 2007) 164.

⁶⁸ Elizabeth Remick, *Building Local States: China during the Republican and Post-Mao Eras* (Harvard University Press 2004).

for tax officials to gather taxable information. Invoices were the only way to record tax information given the underdeveloped information and accounting system.

After the Cultural Revolution, the new Chinese leadership tried to rebuild the tax organ. In 1978, a national tax working conference suggested setting up tax bureaus at the provincial level and sub-bureaus or tax offices in grassroots units,⁶⁹ led by local governments and upper level tax authorities.⁷⁰ The number of tax cadres increased by 80,000, 20,000, 20,000 and 30,000 from 1983 to 1986 respectively.⁷¹ The tax administrative system was constructed. Though the centre retained rights to introduce new taxes and tax-free policies and to set tax rates, the tax administration became decentralized because the centre relied on local authorities to collect tax revenues instead of establishing its own collection apparatus.⁷²

In this period, local government played more of a role in regulating invoices as the authorities had more incentives to improve the administration. From 1963 to 1965, Beijing, Tianjin, Guangdong, Shanghai, Chongqing and Anhui all enacted regulations or rules about invoice administration. At the end of the Cultural Revolution, more provinces like Sichuan, Jiangsu, Heilongjiang, Fujian, Hunan and Guangxi drew up

⁶⁹ Chonghao Yin, *Zhongguo shuishou tongshi [The General History of Taxation in China]* (Guangming Daily Publisher 1991) 1112.

⁷⁰ *ibid* 1113.

⁷¹ *ibid* 1114, 1115.

⁷² The World Bank, *China: Revenue Mobilization and Tax Policy* (World Bank, 1990) 115.

invoice provisions. By the early 1980s, almost every province had such regulations in place.⁷³

These regulatory strategies focused on unifying the form of invoices, including the content, format, paper, printing unit and stamps. However, they were enforced at the regional rather than the national level. Printing management was a useful and popular strategy to discourage illegal invoices. The state-owned, collective and cooperative enterprises designed a format approved by the local tax authorities and printed in appointed printing plants, while other enterprises and individuals were required to use the invoices issued and printed by the tax bureaus. Then a specified seal should be printed or stamped on the invoice. For example, Guangdong Province adopted a round seal with its name running inside the circle and a pentagram in the middle.⁷⁴

Local government led the invoice regulation due to the decentralized tax system and administration. The Provisional Regulations of National Invoice Management, the first national invoice regulation, introduced by the Ministry of Finance in 1986, left the local authorities a broad space to improve regulation. For example, it failed to unify the form of invoices at the national level.

⁷³ Chonghao Yin, *Zhongguo shuishou tongshi [The General History of Taxation in China]* (Guangming Daily Publisher 1991) 1164, 1165.

⁷⁴ Zhicheng Liu and Pingwu Wang (eds), *Zhongguo renmin gongheguo gongshang shuishoushi changbian di'erbu [Documentary Compilation of Industrial and Commercial Tax of PRC Volume 2]* (China Financial & Economic Publishing House 1988) 241, 245.

Evaluations of the Tax Reform

The tax system left enormous institutional opportunity to evade. On the one hand, due to the decentralized VAT system, local governments and companies had more opportunity to collude and evade taxes, unknown to the central government. On the other hand, the weak administrative capacity could not collect tax and regulate evasions effectively and efficiently. Taxpayers were able to evade VAT through misusing tax invoices. The first of these was forged invoices: for example, one factory printed more than 6,000 invoices without permission for seven companies or units from 1981 to 1982 in Zhangzhou, Fujian Province. Chongqing City investigated 113 cases of forged invoices and found more than 240,000 such forgeries in 1983.⁷⁵ The second mechanism was the illegally issued invoice. For example, one employee of a people's commune illegally issued an invoice for a chemical factory and earned 4,100 RMB doing so. The third was stolen invoices. Jilin City prosecuted 634 enterprises that had illegally issued, printed and stolen invoices.⁷⁶ Fourthly, invoices may be legally issued but wrongly used: employees might misuse invoices to reimburse fictitious expenses.⁷⁷ Finally, invoices might be wrongly written up. For example, there were three copies of an invoice—the bookkeeping, deduction and invoice

⁷⁵ SAT, *Shuishou gongzuo wenxian huibian (1978–1992)* [*Documentary Compilation of Tax Work 1978–1992*] (Law Press 1993) 463.

⁷⁶ Fuzhong Wang, 'Fahuopiao guanli loudong duo' [Numerous Loopholes of Invoice Management], (1982) 3 *Jinrong* (Finance).

⁷⁷ Xianzhou Gao, *Zhongguo fapiaoshi* [*The History of Fapiao in China*] (China Taxation Publishing House 2010) 229.

copies; the taxpayer would enter a larger amount in the last of these so that both taxpayers and consumers benefited from it (大頭小尾).⁷⁸ Corruption and embezzlement became prevalent among tax officials because invoices and other tax records were neither standardized nor securely stored. Tax officials were thus able to change the amount of taxes on the formal tax records. For instance, from 1979 to 1982, a tax bureau of Hubei Province investigated invoices and found an overcharge of 3.02 million and an undercharge of 2.86 million from taxpayers. Moreover, 37 tax administrators had taken bribes totalling 110,000 and 64 had embezzled 190,000.⁷⁹ The immature invoice administration not only led to enormous tax fraud among taxpayers, but also encouraged misconduct of the government officials.

Social norms of compliance were also weak. Prevalent tax evasions, of course, undermined the civic virtue of tax compliance. The poor economic development increased moral discontent with paying taxes. The relationship between tax authorities and taxpayers was thus antagonistic. In County J, I heard a miserable story from Mr. Yang (P2), the vice chief of Bureau P.⁸⁰ In September 1986, Mr. Cai, a tax official of Bureau P, was killed by a taxpayer when he was trying to climb onto the taxpayer's tractor to collect taxes. After that, several episodes of violent tax resistance happened.

⁷⁸ Xianzhou Gao, *Zhongguo fapiaoshi [The History of Fapiao in China]* (China Taxation Publishing House 2010) 230.

⁷⁹ *ibid* 232.

⁸⁰ The story was documented in the local newspaper and was later mentioned in several reports to show how the bureau improved the reputations of tax officials. To protect the privacy of the bureau, I do not cite the source.

At that time, tax officials were dubbed by taxpayers “the big beggars” (大款乞丐).

An old tax official wrote in his diary, titled “The Elegy of Tax Collection” (稅務悲歌):

I cannot imagine how weak the taxpaying awareness among national citizens and how bad the working environment of tax collection...I hope that taxpayers, tax collectors and social parties can take action to avoid such a strategy happening again. I hope the day of the harmonious relationship between taxpayers and tax authorities comes earlier.

To summarize, there were in this period some improvements in tax administration, but the system remained manually operated, changeable, inconsistent and non-standardized. Tax compliance was low due to poor economic performance, problematic local and central fiscal relations, and weak administrative capacity.

The Dual VAT System Period (1994–2016)

Semi-Decentralized VAT Administration

The new system encouraged local governments to develop their economies, but the extreme decentralization led to a rapid decline in the fiscal capacity of the centre.⁸¹ In order to balance financial relations, the centre came up with the division

⁸¹ From 1978 to 1996, the ratio of total revenue to GDP plunged from 31 per cent to less than 11 per cent; in 1993, the ratio of central government revenue fell from 2/3 to 1/3. See Jean Oi, ‘Fiscal Reform and the Economic Foundations of Local State Corporatism in China’ (1992) 45 *World Politics* 99; Shaoguang Wang and Angang Hu, *Zhongguo guojia nengli baogao [Report of Chinese State*

of taxes system in which ‘the central and provincial governments [had] their own respective fixed expenditures and revenue sources’,⁸² and ‘shared receipts from several locally-collected taxes’ in 1994.⁸³ Central taxes incorporated consumption tax, custom tax, tonnage duty and vehicle purchase tax; local taxes included BT, property tax, deed tax, operation taxes for vehicles and ships, value-added tax of land, city and town land use tax, land occupation tax, stamp duty and taxes on urban development and maintenance. The centre and province shared VAT and income tax (corporate and individual income taxes).

At the end of 1993, China set up two administrative tax systems: state and local taxation offices (國家稅務局和地方稅務局) (Figure 8). Besides the central taxes, the state bureau also administered shared taxes such as VAT and part of corporate income taxes. The local bureau managed local taxes, individual income tax and part of corporate income taxes.⁸⁴ There were four levels in the state taxation structure: the state administration of taxation (SAT), the provincial office, the municipal office

Capacity](Liaoning Publisher, 1993) 26; Shaoguang Wang, ‘China’s 1994 Fiscal Reform: An Initial Assessment’ (1997) *Asian Survey* 801.

⁸² Michel Oksenberg and Tong James, ‘The Evolution of Central-Provincial Fiscal Relations in China, 1971–1984 The Formal System’ (1991) 125 *The China Quarterly* 1, 32.

⁸³ Shaoguang Wang, ‘China’s 1994 Fiscal Reform: An Initial Assessment’ (1997) *Asian Survey* 801, 817.

⁸⁴ Taxpayers who pay VAT are required to report corporate income tax to state tax bureaus, and taxpayers who pay BT are required to report corporate income tax to local tax bureaus. See SAT, ‘Guanyu tiaozheng qiye suodeshui zhengguan fanwei wenti de tongzhi’ [Notice on Adjusting the Collection Scope of Corporate Income Tax Law] (26 December 2008) <<http://www.chinatax.gov.cn/n810341/n810755/c1226770/content.html>> accessed 9 December 2015.

(including directly governed city and autonomous regions) and the county office.⁸⁵

The county-level taxation office was permitted to build sub-offices or stations.⁸⁶ The administrative dimensions, with respect to institution, cadre, fund and leader's position, were vertically managed. To illustrate, the upper state bureaus appointed and approved the president and vice president of the lower state tax bureaus.

Local administration of taxation was established based on the administrative hierarchy of China. There were three levels: the provincial local taxation bureau (including directly governed city regions and autonomous regions), the municipal local taxation bureau and the county local taxation bureau. Their administrative systems, institutional arrangements and recruitment were expected to follow the regulation of local governments. Both local governments and the SAT led local administration of taxation, but the former played the major role. The SAT leadership focused on the instruction and coordination of tax policy and business, supervision of the tax system and policy, and communication of good practice. In other words, the relationship between SAT and local administration of taxation seemed more cooperative than supervisory. One small example makes the point: the candidate for

⁸⁵ See SAT, 'Guanyu zujian zai gedi de zhishu shuiwu jigou he difang shuiwuju de shishi yijian' [Implementation Guideline of Establishing Directly-Governed Tax Institutions and Local Tax Bureaus] (4 December 1993) <http://www.pkulaw.cn/fulltext_form.aspx?Gid=8997> accessed 9 December 2015.

⁸⁶ Local taxation bureaus at the county level can also build sub-offices or stations.

the president of the provincial local administration of taxation was approved and appointed by local government after seeking opinions from the SAT.

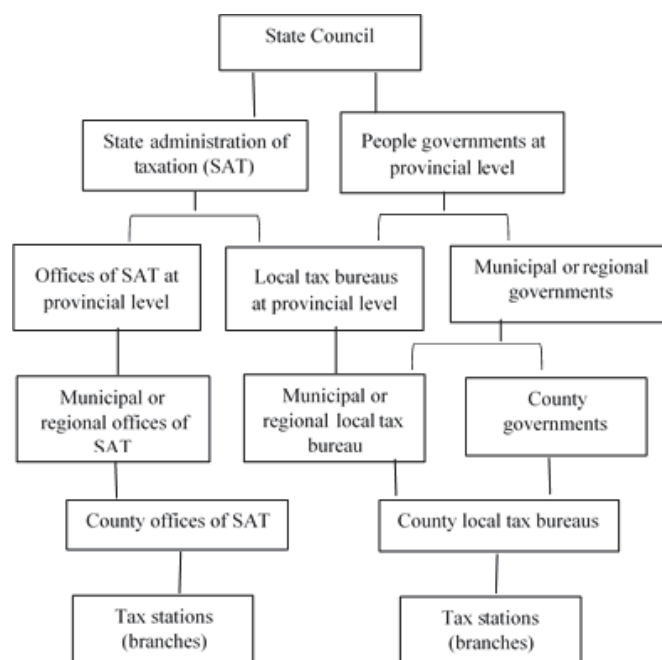


Figure 8. Organizational Chart of China's Tax Administration⁸⁷

Design of the VAT System

Invoices can be sorted into two categories: VAT and BT. The VAT invoice incorporates the VAT special invoice (VATSI, 增值稅專用發票), the VAT general invoice (VATGI, 增值稅普通發票) and the state general invoice (SGI, 國稅普通發票). Different VAT taxpayers are allowed to use different VAT invoices. When both parties are VAT general taxpayers (增值稅一般納稅人), having passed a threshold of annual taxable turnover and able to prepare accounting, they are allowed to use all three. When the seller is a VAT small taxpayer (增值稅小規模納稅人), which means

⁸⁷ See SAT, 'Organizational Chart of China's Tax Administration' <<http://www.chinatax.gov.cn/2013/n2925/n2959/c307250/content.html>> accessed 20 October 2016.

it is smaller and does not provide accounting, it can only issue the SGI. When the seller is a VAT general taxpayer and the buyer is a VAT small taxpayer, the seller can issue either the VATGI or the SGI to the buyer (Table 4). SGI cannot be deductible. VAT small taxpayers pay VAT based on gross turnover. The tax rate for VAT general taxpayers is 17 per cent, while VAT small taxpayers' rate is 3 per cent.⁸⁸

BT invoices (local general invoices, 地稅普通發票), administered by the local tax office, are used by taxpayers who came from the sectors of transportation, construction, finance and insurance, communication, culture and sports, entertainment and services (e.g. hotels and restaurants).⁸⁹ When the sellers are BT taxpayers, they can only issue LGI to buyers (Table 4).

Table 4. The Use of Invoices

		Buyers		
		VAT general taxpayer	VAT smaller taxpayer	Others
Sellers	VAT general taxpayer	VATSI, VATGI, SGI	VATGI, SGI	VATGI, SGI
	VAT smaller taxpayer	SGI	SGI	SGI
	BT taxpayers	LGI	LGI	LGI

There are three methods of computerizing VAT liability: general computerization, simple computerization and fixed amount computerization (核定征收) (Table 5).⁹⁰ In the first two methods, taxpayers pay tax according to their actual business turnover, while in the last, tax officials assess the amount of payable taxes based on the taxpayer's size, number of employees, economic level of the street and

⁸⁸ See Articles 2 and 11 of the Provisional Regulations of the PRC on VAT.

⁸⁹ See Articles 2 and 3 of the Provisional Regulations of the PRC on BT.

⁹⁰ See Article 35 of Law of the PRC on the Administration of Tax Collection, amended 24 April 2015.

area, average turnover of the same industry, etc., because the businesses themselves are too small to meet accounting requirements. Smaller businesses, especially individual industrial and commercial entrepreneurs (also called individually-owned businesses, 個體工商戶), are assessed when they are set up and the amount of tax confirmed then.

In order to reduce the tax burden for small businesses, the SAT decided that after 1 October 2014, VAT small taxpayers and BT taxpayers with a monthly turnover of less than 300,000 RMB could be exempted from VAT or BT.⁹¹ This policy has operated for three years and remained unchanged until now.

Table 5. The Computerizations of VAT Liability

Type of taxpayers	Method of tax collection	VAT payable
VAT general taxpayer	General computation	Output VAT - input VAT
VAT small taxpayer	Simple computation	Sales amount × tax rate (3%)
Fixed amount taxpayer	Fixed amount collection	Decided by tax authorities

The Reform of VAT Administration

Since the fiscal reform in 1994, China has adopted numerous strategies to enhance VAT administration. These strategies comprise using technology to improve regulation on fraudulent invoices, building a risk management system and launching annual campaigns to enhance law enforcement, initiating organizational reforms to strengthen the independence of audit departments, and encouraging a service-based

⁹¹ SAT, ‘Guanyu xiaowei qiye mianzheng zengzhishui he yingyeshui youguan wenti de gonggao’ [The Announcement about Tax Exemption among Small and Micro Businesses] (11 October 2014) <<http://www.chinatax.gov.cn/n810341/n810755/c1151131/content.html>> accessed 24 April 2015.

climate to promote voluntary cooperation.

Technology-based administration. Besides a series of government crackdowns on illegal invoice crime,⁹² both the central and local taxation authorities initiated a number of technological strategies to deter illegal invoices. The central tax authority launched the GTP in March 1994,⁹³ and local governments also initiated several technological measures.

The GTP has three phases. In phase I (1994–1998), the government began to experiment with the VAT cross-audit system and anti-counterfeiting tax control system in some regions. Since 1 January 1996, taxpayers who issue VATSI to a value

⁹² The Criminal Law of the PRC provides for several types of invoice-related offence such as falsely issuing and illegally selling or purchasing VAT special invoices or other invoices to defraud export tax refunds or to offset taxes, and forging or selling forged VAT special invoices. These are punished by imprisonment or criminal detention of less than three years and a fine of between 20,000 RMB and 200,000. For cases involving relatively large amounts of falsely reported taxes, or which are otherwise of a serious nature, imprisonment of three to ten years can be imposed, with a fine of 50,000 to 500,000. Cases involving large amounts of falsely reported taxes, or which are of a more serious nature, may be punished by imprisonment of ten or more years (including life), with a fine of 50,000 to 500,000, or with forfeiture of property (Articles 205–208).

⁹³ In the 1990s, the Chinese government introduced several “golden projects” intended to develop the informational infrastructure and modernize government services. These incorporated the Golden Customs Project, aimed at “linking customs services with an EDI (electronic data interchange) network”; the Golden Card Project, focused on establishing an national credit card network and trust management system; the Golden Bridge Project, targeted with building an integrated national internet platform; and the GTP, which centred on using technology and shared information to enhance tax compliance and reduce VAT fraud. See Tang Jinhong, ‘The Four Golden Projects in China: The Pathway to Electronic Commerce’ (1998) 14 Information Development 133, 135.

of 1 million RMB have had to install this system.⁹⁴ In phase II (1998–2003), taxpayers were able to issue 100,000 worth of VATSI. All written VATSI have been forbidden since 1 April 2002.⁹⁵ In 2001, six subsystems were launched to manage VAT in a standardized and systematic way.⁹⁶ After the first two stages were completed, the SAT embarked on phase III in 2010 to enhance the integration of information. Phase III has had ‘a revolutionary impact on the development of the tax collection and administration as it becomes a full-fledged platform’.⁹⁷

However, the GTP only applies to VAT general taxpayers. It allows them to issue VATSI, VATGI and SGI through the issuing system.⁹⁸ To some extent, it can reduce the level of forged SGIs. In 2009, the SAT formulated a proposal for unifying the form of general invoices (SGI and LGI). It suggested simplifying the type, unifying

⁹⁴ See SAT, ‘Guojia shuiwu zongju guanyu jiaqiang liyong fangwei shuikong xitong kaiju de baiwanyuan yishang zengzhishui zhuanrong fapiao shuju shangbao gongzuo de tongzhi’ [SAT’s Guidelines on Issuing More Than One Million VATSI through Issuing System] (22 November 1996) <http://www.tax.sh.gov.cn/pub/xxgk/zcfg/swzsgl/200706/t20070612_284660.html> accessed 20 November 2015.

⁹⁵ *ibid.*

⁹⁶ SAT, ‘Ongoing Tax Administration Reform of China’ [The Sixth High Level Tax Conference for Asian Countries 2015] <<https://www.imf.org/external/np/seminars/eng/2015/asiatax/pdf/yang.pdf>> accessed 11 November 2015.

⁹⁷ *ibid.*

⁹⁸ See SAT, ‘Guojia shuiwu zongju guanyu tuixing zengzhi fangwei shuikong yiji duopiao xitong de tongzhi’ [The SAT’s Announcement on Performing Issuing System of One Machine, Multi-Invoice] (5 June 2006) <<http://www.chinatax.gov.cn/n810341/n810765/n812183/n812851/c1197443/content.html>> accessed 22 November 2015.

the format, establishing a platform and issuing invoices online.⁹⁹ Firstly, the SAT encouraged local authorities to use machine-printed rather than written invoices so that tax authorities would find it easier to improve the efficiency of monitoring and reduce the cost to taxpayers. Secondly, it provided invoice models and requirements such as the width and length of pages, number of copies, content, stamps and the like. Since then, the image of general invoices has changed greatly. Since 2011, the SAT has also encouraged business taxpayers to issue tax invoices through an online invoice management system.¹⁰⁰ Online invoices are safer than machine-printed invoices because a randomly generated tax number is allocated to each receiver; thus they are harder to forge.

The local tax authorities also made efforts to improve the quality of invoices. Some developed areas initiated new methods to combat forged invoices. The Beijing Municipal Tax Office, for example, printed the verifying methods on the back of a machine-printed invoice. If the oval-shaped red stamp—the standard invoice stamp

⁹⁹ See SAT, ‘Quanguo putong fapiao jianbing piaozhong tongyi shiyang gongzuo shishi fang’an’ [SAT’s Proposal on Simplifying the Type and Format of General Invoice] (30 September 2009) <<http://www.chinatax.gov.cn/n810341/n810765/n812166/n812612/c1087024/content.html>> accessed 22 November 2015.

¹⁰⁰ See SAT, ‘Notice of the State Administration of Taxation on Issuing the Framework for Taxation Development during the “12th Five-Year Plan” Period’ (29 April 2011) <<http://www.chinatax.gov.cn/n810214/n810626/c1106074/content.html>> accessed 22 November 2015. According to Wangluo Fapiao Guanli Banfa [Measures for the Management of Online Invoices] (25 February 2013), online invoices means invoices in compliance with the uniform standards of the SAT which are issued through their online invoice management systems and the state and local taxation bureaus of the provinces, autonomous regions and municipalities directly under the central government.

nationwide (全國統一發票監製章)—was exposed to UV light (e.g. a currency detector), it would show as orange. If a temperature source of at least 35° centigrade (e.g. one’s fingers) was held to the area of thermal induction on the reverse of an invoice for three seconds, the picture on the front would become light or colourless. If the stamp was magnified eight times or more, the characters “Beijing Municipal Tax Office” (北京地稅) could be seen inside. Local tax authorities also provided official websites where one could verify an invoice by typing in the invoice number, invoice code and password. The Shenzhen Municipal Tax Office used a quick response code to verify invoices. People scanned the code to obtain information about the invoice. To encourage consumers to ask for an invoice, tax invoices included a prize in the top right corner. Tax authorities also provided rewards for reporting illegal invoicing behaviours.

Risk-based regulation and annual campaigns. To discourage VAT frauds, state tax offices have adopted a risk-based approach to enhance cooperation between tax authorities and taxpayers. The risk rating is based primarily on two factors: the tax burden ratio and the variations of sales.¹⁰¹ The tax burden ratio is the ratio between the annual amount of VAT liability and the annual revenue. Each city decides the tax burden ratio for each industry based on the performance of the local economy—for example, the tax burden ratio in shoe manufacturing was 4.25 per cent in the city

¹⁰¹ SAT, ‘Tuijin shuiwu jicha suiwei choucha shishi fang’an’ [The Implementing Plan on Promoting the Random Tax Audit] <<http://www.chinatax.gov.cn/n810341/n810755/c1789546/content.html>> accessed 15 February 2017.

where I conducted fieldwork. A risk management system, which detects any unusual or fluctuating rates, alerts the county tax office to which companies are likely to be evading taxes.

Annual campaigns on combatting fraudulent invoices are also critical in deterring tax evasion. Table 6 shows 78 significant cases that local tax authorities found from 2009 to 2014. The most significant case happened in Inner Mongolia in 2014. A total of 3.8 billion RMB input tax was evaded.

Table 6. Overview of Significant Cases of VAT Invoice Violations (2009–2014)¹⁰²

No. of companies that kept fraudulent invoices	No. of cases	The amount of taxes evaded (Millions, RMB)	No. of cases	No. of provinces covered	No. of cases
<50	23	<10	15	<5	9
50–100	4	10–50	19	5–10	8
101–200	5	50–100	4	11–20	9
201–500	2	100–500	7	>20	5
>500	7	>500	2		
Total	41		47		31

Organizational reforms. Institutional reform and the uniform procedural guidance help to reduce arbitration and discretion during the law enforcement process. Since the 1990s, tax authorities have clarified the relationship among collection, administration and audit. In particular, cases investigating violations of tax laws shall remain only with the audit office.¹⁰³ The SAT also seeks to reform the

¹⁰² See SAT Auditing Bureau, *China Taxation Auditing Yearbook (2010–2015)*. The Yearbook reported several important cases on tax noncompliance. I collected the cases which are related to VAT evasions. A total of 78 such cases were documented from 2009 to 2014. The cases of export VAT violations are excluded.

¹⁰³ SAT, ‘Guojia shuiwu zongju guanyu jingyibu jiaqiang shuishou zhengguan jichu gongzuo ruogan

system of tax administrators by changing from territorial jurisdiction to category and degree-based jurisdiction, which can lessen corruption and arbitration.¹⁰⁴

Service-based tax climate. To promote voluntary compliance, the SAT has, since 2003, promoted the creation of a service-based tax climate.¹⁰⁵ Several strategies have been adopted to improve the efficiency of service and administration, including establishing a self-reporting system, simplifying procedures of managing tax affairs, computerizing tax services, information disclosure, urging honest and lawful behaviour, setting up the 12366 hotline service and the like.¹⁰⁶

wenti de yijian' [Opinions of the SAT Concerning Some Issues on Further Strengthening the Basic Work of Tax Administration] (22 October 2003) <<http://www.chinatax.gov.cn/n810341/n810765/n812198/n813046/c1204889/content.html>> accessed 2 September 2017.

¹⁰⁴ The SAT, 'Guojia shuiwu zongju guanyu jinyibu shenhua shuiwu xitong "fangguanfu" gaige youhua shuishou huanjing de ruogan yijian' [Opinions of the SAT Concerning Some Issues on Further Strengthening the Reform of Simplification of Administrative Procedures, Decentralization of Powers, and Optimization of Service, and Perfecting the Taxation Environment in Tax Administration] (20 September 2017) <<http://www.chinatax.gov.cn/n810219/n810724/c2828955/content.html>> accessed 10 October 2017.

¹⁰⁵ See SAT, 'Guojia shuiwu zongju guanyu jingyibu jiaqiang shuishou zhengguan jichu gongzuo ruogan wenti de yijian' [Opinions of the SAT Concerning Some Issues on Further Strengthening the Basic Work of Tax Administration] (22 October 2003) <http://www.chinatax.gov.cn/n810341/n810765/n812198/n813046/c1204889/content.html> accessed 2 September 2017.

¹⁰⁶ The SAT, 'Guojia shuiwu zongju guanyu jinyibu shenhua shuiwu xitong "fangguanfu" gaige youhua shuishou huanjing de ruogan yijian' [Opinions of the SAT Concerning Some Issues on Further Strengthening the Reform of Simplification of Administrative Procedures, Decentralization of Powers, and Optimization of Service, and Perfecting the Taxation Environment in Tax Administration] (20 September 2017) <<http://www.chinatax.gov.cn/n810219/n810724/c2828955/content.html>> accessed 10 October 2017.

Evaluation of the Tax Reform

Since 1994, tax authorities have made numerous efforts to reduce opportunities to evade and improve social norms to comply. The more centralized control over taxation will reduce the considerable divergence in tax enforcement and administration across the country. Technology-based administration and several organizational reforms have reduced the opportunities for taxpayers to evade. A service-based tax climate can promote voluntary cooperation. VAT has therefore become the most important revenue source for central government, and BT is the largest tax revenue source for local governments.¹⁰⁷ On average from 1994 to 2014, VAT accounted for around 35 per cent of annual tax revenue. BT has also seen remarkable growth since 1994. The VAT family yielded on average around 50 per cent of annual tax revenues. The ratio of VAT family revenue relative to GDP rose from 3.94 per cent in 1985 to 8.16 per cent in 2007 (Figure 9).

¹⁰⁷ Yan Xu, 'A Historical Account of Taxes on Goods and Services in the Transition to Post-Socialist China' in Peter Harris and Dominic de Cogan (eds), *Studies in The History of Tax Law* (Volume 7, Hart Publishing 2015) 393, 420.

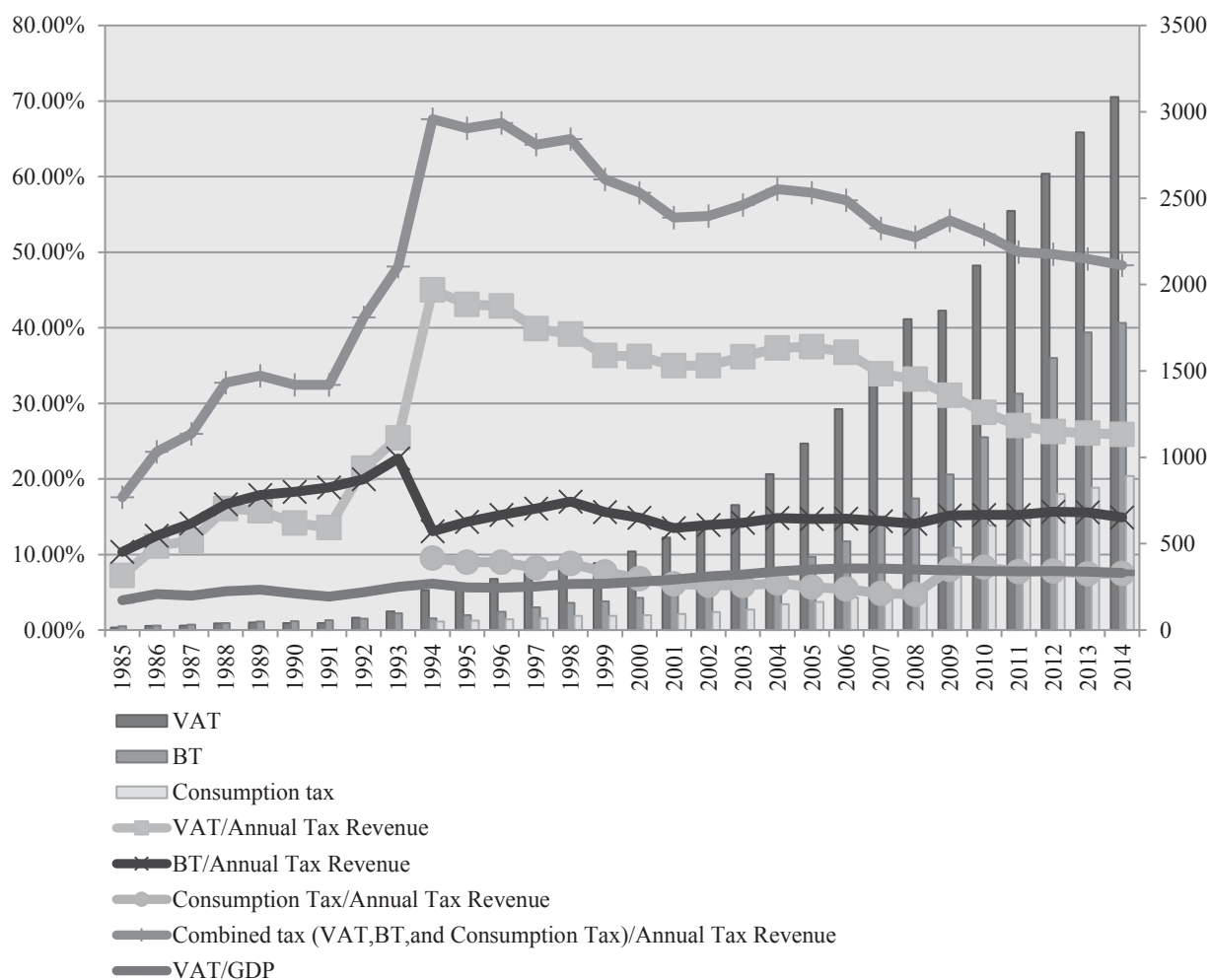


Figure 9. Shares of VAT Family (1985–2014) (Billions, RMB)¹⁰⁸

The existing designs of VAT and administration, however, retain opportunities to evade. VAT taxpayers who are levied fixed-amount taxes, VAT small taxpayers, and BT taxpayers have the chance to conceal their annual turnover, because tax authorities cannot see the amount of their transactions until they issue tax invoices. Even VAT general taxpayers who rarely issue tax invoices can evade VAT without being detected. On the other hand, taxpayers also have the opportunity to receive fraudulent

¹⁰⁸ Import VAT is excluded. Consumption tax was introduced in 1994. See National Bureau of Statistics of the PRC, *China Statistics Book (1985–2013)* <<http://www.stats.gov.cn/tjsj/ndsj/>> accessed 22 November 2015.

input invoices which are not based on genuine transactions. They use such invoices to deduct more input tax and thus reduce VAT liability.

The fairness of the tax system is often questioned. Not all sales of goods and services bear the same tax rate since goods and limited services are governed by VAT while most services are levied by BT. This separation makes some taxpayers unable to enjoy the lower tax rate, whereas VAT general taxpayers are unable to deduct input tax on the purchase of real property and intangible property.

The Single VAT System Period (2016–Present)

Centralized VAT Administration

The dual tax system increased the tax burden for taxpayers and broke the VAT deduction chain. Moreover, most companies preferred self-service to buying an external service because the BT contained in the service cannot be deducted. This has hindered the development and export of the modern service industry. Tax officials also find it difficult to distinguish goods from services.¹⁰⁹ To eliminate these problems, promote the changing economic structure and support the modern service industry, China has experimented with VAT reform in Shanghai since 1 January 2012.¹¹⁰

¹⁰⁹ Kang Jia, ‘Weihe woguo yingyeshui yao gaicheng zengzhishui’ [Why should China Replace BT with VAT?] <<http://business.sohu.com/20120225/n335861090.shtml>> accessed 9 December 2015.

¹¹⁰ Ministry of Finance and the SAT, ‘Yingyeshui gai zengzhishui shidian fang’an’ [The Pilot Proposal on BT to VAT] (16 November 2011) <http://szs.mof.gov.cn/zhengwuxinxi/zhengcefabu/201111/t20111117_608456.html> accessed 9 December 2015.

Under the VAT reform, transportation and certain modern services—such as information technology, cultural and creative industries, logistics, movable property leasing, and certifying and consulting services—all now levy VAT instead of BT.¹¹¹ The SAT administers around 50 per cent of annual tax revenue since the VAT reform.¹¹² Local governments were motivated to implement the reform because the sharing of VAT between the central and local levels was temporarily settled at 50 per cent each, and local government could benefit from the reform as a way of attracting investors.¹¹³ BT was officially removed on 1 December 2017.¹¹⁴

“Internet and Tax” Administration

To support the new VAT reform, the GTP phase III, a new tax management system, has been running smoothly and successfully online and in Beijing, Shanghai and other places.¹¹⁵ It aims to achieve consistent tax administration backed by

¹¹¹ Jane Winn and Angela Zhang, ‘China’s Golden Tax Project: A Technological Strategy for Reducing VAT Fraud’ (2013) 4 Peking University Journal of Legal Study 1, 33.

¹¹² National Bureau of Statistics of the PRC, *China Statistics Book (1985–2013)* <<http://www.stats.gov.cn/tjsj/nds/>> accessed 22 November 2015.

¹¹³ The People Daily, ‘Yinggaizeng jiang quanmian “luodi kaihua”’ [Replacing BT with VAT Reform Will be Implemented] <http://news.ifeng.com/a/20160127/47262124_0.shtml> accessed 31 January 2016).

¹¹⁴ The State Council, ‘Guowuyuan guanyu feizhi <zhonghua renmin gongheguo yingyeshui zanxing tiaoli> he xiugai <zhonghua renmin gongheguo zengzhishui zanxing tiaoli> de jue ding’ [The State Council’s Decisions on Abolishing the Provisional Regulations of the PRC on BT and Revising the Provisional Regulations of the PRC on VAT] (19 November 2017) <http://www.gov.cn/zhengce/content/2017-12/01/content_5243734.htm> accessed 1 December 2017.

¹¹⁵ See SAT, ‘Development of IT-Based Taxation’ (25 November 2016) <<http://www.chinatax.gov.cn/>

information technology and processing of tax data in a highly efficient manner nationwide.¹¹⁶ This system optimizes tax risk identification and case selection for tax investigation. It reserves an interface for connecting with different levels of tax authority and external relevant departments so that tax data can be verified on a real-time basis with information obtained from the system used by banks, customs, industry and commerce administrations, etc. It is anticipated that the tax authority's capacity and efficiency in detecting tax risks will be greatly improved after complete implementation of the project.¹¹⁷

Furthermore, the new project can implement stringent procedural regulations. Regulators are required to deal with tax assignments through a computer information system. Most of their work is assigned by the system. A system-centred tax administration has several advantages. Regulating the tax agencies using an information system and persuasion rather than command and control will increase the legitimate power of regulation. Tax officials will find it risky to engage in misconduct.¹¹⁸ Having more efficient and formal procedures will also enhance the legitimacy of the tax authority and therefore tax compliance.

eng/n2367721/c2390193/content.html> accessed 2 December 2017.

¹¹⁶ See PwC, 'New Big Data for Tax Administration: What to Expect from China's Golden Tax III Project' (September 2016) <<https://www.pwccn.com/en/services/tax/publications/chinatax-news-sep2016-24.html>> accessed 2 December 2017.

¹¹⁷ *ibid.*

¹¹⁸ Giandomenico Majone, 'The New European Agencies: Regulation by Information' (1997) 4 *Journal of European Public Policy* 262, 275.

After the VAT reform, LGI will disappear because all industrial and commercial taxpayers will pay VAT. Therefore, nationwide VAT information can be administered and monitored within the GTP. In 2016, the SAT developed a system for the VAT electronic general invoice (EGI) that enables taxpayers to issue electronic invoices.¹¹⁹ For one thing, the EGI saves social and administrative costs. Taxpayers do not need to apply for invoices from the tax authorities. The tax authorities can also save large amounts of money by not having to print, purchase, deliver and store invoices. Furthermore, EGI allows taxpayers to verify themselves online immediately. More information will be shown on the electronic records, including the name of the buyer and seller, the item, price, date and the like. The use of EGI will effectively reduce the number of forged or fraudulent invoices. Such state-led invoice regulation also enables the government to centralize and share information nationally and hence improve the efficiency and effectiveness of enforcement.¹²⁰

¹¹⁹ See SAT, ‘Guanyu tuixing tongguo zengzhishui dianzi fapiao xitong kaiju de zengzhishui dianzi fapiao youguan wenti de gonggao’ [The SAT’s Notice on Issuing VAT EGI through VAT EGI System] (26 November 2015) <<http://www.chinatax.gov.cn/n810341/n810755/c1919901/content.html>> accessed 9 December 2015.

¹²⁰ Yanhong Cai, ‘Wangluo fapiao guanli chayan xitong shandong shangxian: dianzi fapiao zhenjia yimu liaoran’ [The Implementation of Online Invoice Verifying System in Shandong: Whether the Electronic Invoice is Real or Not Is Clear] <<http://epaper.legaldaily.com.cn/fzrb/content/20140619/Article06008GN.htm>> accessed 10 December 2015.

Preliminary Evaluations of the Tax Reform

The ongoing VAT reform is significant to integrate the VAT system, enhance tax administration and implement stringent legal control, as well as to promote fairness of the tax system. It is anticipated that the institutional capacity to deter tax evasions will be substantially improved following implementation of the reform. However, the GTP phase III might be ineffective for those who are engaging in the shadow economy. In the current VAT reform, BT taxpayers are only transferred from local tax authorities to state tax authorities: the way of tax collection remains unchanged.

However, to what extent the tax reform can enhance social norms of voluntary compliance remains questionable. It is obvious that the current tax reform focuses largely on reducing opportunities to evade, which might improve the horizontal norm of compliance. The exchange norm that considers the amount of taxes and fiscal benefits has not been much improved. If the tax burden is shown to be too high for taxpayers, taxpayers are unlikely to pay taxes honestly. The unfair distribution of resources between small and large companies might also contribute to resistance to paying taxes. All these questions can be answered only when the effects of the current ongoing VAT reform are further examined.

Conclusions and Implications

This chapter raises an important question: did the three VAT reforms promote tax compliance in China? If yes, how did they work? Examining the evolution of the VAT system under the three major tax reforms, this chapter suggests that overall

VAT compliance has been improved gradually because opportunities to evade have been reduced and social norms of compliance have been promoted. Opportunities to evade have been reduced because of the more centralized VAT system, the efforts made to enhance technology-based administration, and other organization reforms. The more integrated VAT system has reduced the loopholes in the tax system and institutional motivations for levying taxes, and provided a complete chain of deduction for VAT taxpayers. Better tax law and design, of course, will improve legal compliance. The technology-based tax administration enhances intuitional capacity to detect tax risks and violations, as well as enhancing procedural regulations. If the opportunity to evade has been reduced, the social norms of compliance, especially horizontal norms, will also be improved.

The VAT reforms have some limitations, however. On the one hand, the reforms have been focused more on combatting taxpayers who enter the VAT system: taxpayers who are disengaged still have many opportunities to evade taxes. On the other hand, though more reasonable tax designs and consistent legal control over VAT violations can promote social norms of compliance, they might bring about the reverse impact in the light of taxpayers' low willingness to pay taxes due to high tax burden, the unfair distribution of social and political resources between small and larger businesses, and the weak exchange norms between the government and taxpayers.

Chapter Two. Cost-Benefit Decisions about Everyday Practices of the Frontline Tax Officials

China has long been labelled a weak and lax enforcement country due to the limited organizational capacity,¹²¹ corruption and local protectionism.¹²² To curb the discretion of enforcement agencies and overcome misimplementation, the central government launched various political legal campaigns to enhance enforcement (also called ad hoc enforcement, selective enforcement or strike hard),¹²³ known as ‘a pattern of long periods of weak and lax enforcement, followed by short periods of strong and coercive enforcement.’¹²⁴

¹²¹ See Sean Cooney, ‘Making Chinese Labor Law Work: The Prospects for Regulatory Innovation in the People’s Republic of China’ (2006) 30 *Fordham International Law Journal* 1050, 1097.

¹²² See Andrew Wedeman, *From Mao to Market: Rent Seeking, Local Protectionism, and Marketization in China* (Cambridge University Press 2003); Melanie Manion, *Corruption by Design, Building Clean Government in Mainland China and Hong Kong* (Harvard University Press 2004); Benjamin Van Rooij, *Regulating Land and Pollution in China: Lawmaking, Compliance, and Enforcement; Theory and Cases* (Leiden University Press 2006) 264, 271, 283, 288.

¹²³ Ad hoc enforcement was from Benjamin Van Rooij, *Regulating Land and Pollution in China: Lawmaking, Compliance, and Enforcement; Theory and Cases* (Leiden University Press 2006) 352; selective enforcement was from Zhiyong Dai, ‘Selective Enforcement of Laws’ [*Xuanzexing Zhifa*] (2008) 4 *Faxue Yanjiu* [*Chinese Journal of Law*] 28, 35; strike hard was from Harold Tanner, *Strike Hard: Anti-Crime Campaigns and Chinese Criminal Justice, 1979–1985* (East Asia Program Cornell University 1999).

¹²⁴ Xin He, ‘Regulating Rural-Urban Migrants in Beijing: Institutional Conflict and Ineffective Campaigns’ (2003) 39 *Stanford Journal of International Law* 177, 206; Nicole Ning Liu, Carlos Wing-Hung Lo, Xueyong Zhan and Wei Wang, ‘Campaign-Style Enforcement and Regulatory Compliance’ (2014) 75 *Public Administration Review* 85, 95; Benjamin Van Rooij, ‘The Campaign Enforcement Style: Chinese Practice in Context and Comparison’ in Francesca Bignami and David Zaring (eds),

Another strand of studies has found a mixed enforcement style that is based on a bureaucratic targets (mandates, quotas, top-down personnel assessment, and cadre evaluation) system.¹²⁵ That is, local agencies both “work” very hard and “shirk” very ably. O’Brien and Li defined this as “selective policy implementation” that implements unpopular policies (birth control, revenue collection, funeral reform) and sets popular policies (fee limits, village election, corruption regulation) aside.¹²⁶ Cai found that under the pressures and incentives of the higher level government, local agents tended to engage in statistical inflation.¹²⁷ Birney defined it as the “rule of mandates” distinguished from the “rule of law”, wherein higher priority mandates regarding economic growth and revenue collection undermine lower priority mandates like combatting corruption and enforcing election law.¹²⁸ Instead of examining the relationships between different types of target, recent studies have focused on a single type of target. For instance, in his insightful study, Wang showed

Comparative Law and Regulation: Understanding the Global Regulatory Process (Elgar 2016) 217, 237.

¹²⁵ See Alex Wang, ‘The Search for Sustainable Legitimacy: Environmental Law and Bureaucracy in China’ (2013) 37 *Harvard Environmental Law Review* 365, 440; Genia Kostka, ‘Command without Control: The Case of China’s Environmental Target System’ (2016) 10 *Regulation & Governance* 58, 74.

¹²⁶ Kevin O’Brien and Lianjiang Li, ‘Selective Policy Implementation in Rural China’ (1999) 31 *Comparative Politics* 167, 186.

¹²⁷ Yongshun Cai, ‘Between State and Peasants: Local Cadres and Statistical Reporting in Rural China’ (2000) 163 *The China Quarterly* 783, 805.

¹²⁸ Mayling Birney, ‘Decentralization and Veiled Corruption under China’s Rule of Mandates’ (2014) 53 *World Development* 55, 67.

the role of cadre evaluation in implementing the targets of environment protection, as required by the Eleventh and Twelfth Five-Year Plans. Though the top-down target approach achieved limited positive outcomes, several problems like goal specification, goal displacement, information asymmetry and collusion have undermined environmental implementation.¹²⁹ Kostka further examined the impacts of a targets system on law environmental policy implementation and found four outcomes based on two variables: intended or unintended outcome, and desirable or undesirable outcome.¹³⁰

Similar to previous studies on weak law enforcement in China, this chapter examines how the frontline tax authorities make decisions and what are the underlying factors that lead to such decisions. Differently, it has adopted a cost-benefit analysis to understand the patterns of decisions among tax officials. The study reveals in what circumstances a particular decision is preferred. It further reveals the influence of the pattern on deterrence.

The remainder of this chapter begins with the institutional environment of the frontline tax authorities. It continues with definitions of cost and benefit; then the four different reactions and outcomes based on the cost and benefit analysis will be presented. It will end with discussions.

¹²⁹ Alex Wang, 'The Search for Sustainable Legitimacy: Environmental Law and Bureaucracy in China' (2013) 37 *Harvard Environmental Law Review* 365, 440.

¹³⁰ Genia Kostka, 'Command without Control: The Case of China's Environmental Target System' (2016) 10 *Regulation & Governance* 58, 74.

The Institutional Arrangements of the Frontline Tax Offices

The central and local governments motivate tax authorities to maximize revenues by establishing a binding target system consisting of the tournament system and the cadre responsibility system (cadre evaluation).¹³¹ The semi-decentralized fiscal system has empowered local governments to develop their economy and use partial revenues without constraints; tax bureaus zealously pursue revenue maximization and partially enforce law due to the political and social embeddedness; inconsistent laws, ambivalent procedures and abused discretions enhance the target system.

Fiscal Relations between the Centre and the Localities

After China initiated its socialist transformation modelled on the Soviet Union in 1953, many enterprises became nationalized or collectivized, and there was little resistance to tax collection. From 1950 to the Great Leap Forward, the profits contributed by state enterprises jumped from 13 per cent to 62 per cent of annual revenues.¹³² During the Cultural Revolution (1966–1976), local tax authorities were cancelled or merged, tax officials were demoted, and the taxation system was

¹³¹ For example, Kevin O'Brien and Lianjiang Li, 'Selective Policy Implementation in Rural China' (1999) 31 *Comparative Politics* 167, 186; Alex Wang, 'The Search for Sustainable Legitimacy: Environmental Law and Bureaucracy in China' (2013) 37 *Harvard Environmental Law Review* 365, 440; Graeme Smith, 'Measurement, Promotions and Patterns of Behavior in Chinese Local Government' in Emily Yeh, Kevin O'Brien and Jingzhong Ye (eds), *Rural Politics in Contemporary China* (Routledge 2016) 111, 134.

¹³² Elizabeth Remick, *Building Local States: China during the Republican and Post-Mao Eras* (Harvard University Press 2004) 140.

demolished. After the 1978 plenum,¹³³ China embraced a “reform and opening up” policy and embarked on a nationwide market transformation. Meanwhile, the centre experimented with numerous revenue-sharing arrangements to grapple with fiscal relations between central and local governments. After 1983, the contract system, known as “eating from separate pots” and in which provinces and the centre shared total tax revenues, came to dominate.¹³⁴ The new system encouraged local governments to develop a local economy, but also led to fiscal deficits for the central government.¹³⁵

In order to improve fiscal capacity, in 1994 the centre came up with the division of taxes system in which ‘the central and provincial governments [had] their own respective fixed expenditures and revenue sources’ and ‘shared receipts from several locally-collected taxes’.¹³⁶ Thus, central tax, local tax and shared tax are three major types of tax. VAT, the pillar of the tax system, is shared by the centre (75 per cent) and localities with (25 per cent). Consumption tax belongs to the centre and business tax

¹³³ The Third Plenum of the Eleventh Central Committee of the Chinese Communist Party was the decisive meeting held in Beijing, China, from 18–22 December 1978.

¹³⁴ Elizabeth Remick, *Building Local States: China during the Republican and Post-Mao Eras* (Harvard University Press 2004) 142.

¹³⁵ See Jean Oi, ‘Fiscal Reform and the Economic Foundations of Local State Corporatism in China’ (1992) 45 *World Politics* 99, 126; Shaoguang Wang and Angang Hu, *Zhonghuo guojia nengli baogao* [*Report of Chinese State Capacity*] (Liaoning Publisher 1993) 26; Shaoguang Wang, ‘China’s 1994 Fiscal Reform: An Initial Assessment’ (1997) *Asian Survey* 801, 817.

¹³⁶ Michel Oksenberg and Tong James, ‘The Evolution of Central-Provincial Fiscal Relations in China, 1971–1984 The Formal System’ (1991) 125 *The China Quarterly* 1, 32.

belongs to the localities. The centre shares 60 per cent of corporate income tax, while localities share 40 per cent. The SAT administers the central tax and the shared tax, while the local administration of taxation administers the local tax. Finally, to encourage local governments to develop their economy, the central government has also initiated a transfer payment system. On the one hand, the centre returns a certain amount of tax to localities based on growth regarding the revenue of VAT and consumption tax. When VAT and consumption tax increase by one per cent, the refund increases by 0.3 per cent.¹³⁷ On the other hand, the centre subsidizes the localities based on local needs and their efforts in increasing tax revenues.¹³⁸

Under the system of division of taxes, local governments are motivated to boost their economy by introducing investments and businesses so that they can collect sufficient tax revenues, tax refunds and subsidies to afford enormous expenditures. Not only should local governments ensure fiscal balance, but they also need to achieve certain revenue growth corresponding to GDP growth every year. The mechanisms of the intergovernmental tournament and the cadre responsibility enable the higher level governments to obtain information, give rewards and impose

¹³⁷ The State Council, 'Guowuyuan guanyu shixing fenshuizhi caizheng guangli tizhi de jueding' [The Decision on Implementing the Financial Manageable System of Division of Taxes] (5 December 1993) <http://www.mof.gov.cn/pub/yusuanzi/zhuantilanmu/zhongguocaizhengtizhi/cztzwj/200806/t20080627_54328.htmlhttp://www.mof.gov.cn/pub/yusuanzi/zhuantilanmu/zhongguocaizhengtizhi/cztzwj/200806/t20080627_54328.html> assessed accessed 20 November 2016 .

¹³⁸ Feizhou Zhou, 'Fenshuizhi shinian: Zhidu ji qi yingxiang' [A Decade of Division of Taxes: The System and Its Influence] (2006) 6 Social Sciences in China (Zhongguo Shehui Kexue) 100, 117.

sanctions on the head of the lower level governments.¹³⁹

Tax Bureaus Embedded in the Political and Social Network

Establishing an autonomous or semi-autonomous tax authority with an ability to implement tax laws and policies amid resistance among society is a common practice around the world.¹⁴⁰ In 1988, China removed the General Taxation Bureau from the Ministry of Finance (MOF) and started the SAT to replace its functions. The SAT is a quasi-Ministry whose president reports directly to the State Council, but acting under the guidance of the MOF.¹⁴¹

Though state tax bureaus at local levels are directly governed by the SAT, there are several constraints from local governments. The amount of tax revenues collected by the SAT and the local administration of taxation is the first concern of local governments. In order to ensure fiscal balance and improve performance evaluations, local governments also allocated revenue targets to tax authorities. Despite the

¹³⁹ Katharina Pistor and Chenggang Xu, 'Governing Stock Markets in Transition Economies: Lessons from China' (2005) 7 *American Law and Economics Review* 184, 210.

¹⁴⁰ Ole Therkildsen, 'Autonomous Tax Administration in Sub-Saharan Africa: The Case of the Uganda Revenue Authority' (2004) 31 *Forum for Development Studies* 59, 88.

¹⁴¹ The major responsibilities of the SAT include 'implementation of the taxation objectives of the State Council; administration of national taxes; tax policy; the drafting of national tax laws; the drafting and issue of administrative regulations; the collection of (national) tax revenues; the use of taxation as a macroeconomic level; the management of tax official within provincial governments; training and coordination within the tax system; negotiation with foreign government and representation of China in international bodies; and administration of taxation on offshore oil reserve.' See World Bank, *China: Revenue Mobilization and Tax Policy* (World Bank 1990) 116, 117.

county-levelled state tax bureau being governed by the SAT and independent from the local government, they were constrained by the targets that were required by the local government. Take County J as one example: in 2015, the municipal state tax office assigned County J state tax bureau a target of collecting 10.86 billion RMB, while the county government assigned 11.29 billion. The mechanisms of awards and sanctions were used by local governments to secure reliable implementation from the tax authorities. The local governments rewarded or punished based on the performance of the tax bureaus. The chief of the fifth tax branch of Bureau P (governed by the SAT) (S1) explained to me:

The local government will give a bonus if we meet or exceed the target.

They also decide to reward role models in tax collection or moral and cultural progress (文明單位). They control party affairs and labour unions.

The better the county-level state tax bureaus fulfil the target, the happier the head of the local government, and the more bonuses and rewards they win.

Every leader favours quantified achievements. If the county-level state tax bureaus fail to meet the target, both formal and informal sanctions are a source of concern for the heads. For example, they might be demoted from their position. The local governments and municipal state tax office will scold the leaders of the county-level state tax bureau. They should submit a report to explain why they have failed to meet targets. They lose face. The higher levelled officials will get tough on them by initiating more audits and investigations.

As Cai put it:¹⁴²

In China's case, since the tenure and promotion of lower level officials are decided by their higher level counterparts, they are held more accountable to higher level officials than to the public and thus are more likely to suffer pressure from above.

The state tax authorities at the local level fail to resist interventions from local governments. For instance, local governments encourage investors, larger companies or projects by giving tax-free and several administrative conveniences. It is hard for local level state tax bureaus to audit large companies as local governments are afraid that audits and sanctions might scare away these newcomers.

Tax bureaus also face social constraints in a relational (social connections or social ties, *guanxi* or *renqing* in Chinese) community. In his classic *From the Soil*, Fei suggested that:¹⁴³

Our pattern is not like distinct bundles of straws. Rather, it is like the circles that appear on the surface of a lake when a rock is thrown into it. Everyone stands at the centre of the circles produced by his or her own social influence.

¹⁴² Yongshun Cai, 'Between State and Peasants: Local Cadres and Statistical Reporting in Rural China' (2000) 163 *The China Quarterly* 783, 805.

¹⁴³ Xiaotong Fei, *From the Soil: The Foundations of Chinese Society* (University of California Press 1992) 62.

There are 102 tax officials in Bureau P: 90 of them (88 per cent) are from County J, and the rest are from neighbouring counties or cities. In Bureau R, 14 of 16 (87.5 per cent) are from County J and two are from other counties of the city. The old saying ‘everyone has a cousin three thousand miles away’ implies the vastness of kinship networks in Chinese society.¹⁴⁴ In the county, people establish relationships not only through blood relations, but also through friends, classmates, comrades-in-arms and townsmen.¹⁴⁵ Moreover, the internal network of bureaucrats enhances the embeddedness. Feng studied the political network in Zhong County of Henan Province. Managers contend that ‘youth is precious, capability is for reference, *guanxi* is the most important (年齡是個寶，能力做參考，關係最重要)’.¹⁴⁶ They built up the network through drinking, playing cards and gift-giving.¹⁴⁷ Social ties played a critical role in the internal and external circumstances of tax authorities.

Building relationships with various governmental agencies and tax officials is imperative for firm survival.¹⁴⁸ Relational businesses are capable of using these

¹⁴⁴ *ibid* 63.

¹⁴⁵ Junqi Feng, ‘Zhongxian ganbu’ [Zhong County’s Cadres] (DPhil thesis, Peking University 2010) 161.

¹⁴⁶ *ibid* 171.

¹⁴⁷ Junqi Feng, ‘Zhongxian ganbu’ [Zhong County’s Cadres] (DPhil thesis, Peking University 2010) 164.

¹⁴⁸ Shibin Sheng, Kevin Zheng Zhou and Julie Juan Li, ‘The Effects of Business and Political Ties on Firm Performance: Evidence from China’ (2011) 75 *Journal of Marketing* 1, 15.

political and social connections to avoid audits or sanctions or to receive help to comply creatively with the tax law.

Too Many Discretions: Tax Legislations, Procedures and Administrative Litigations

Street-level bureaucrats normally have wide discretion in deciding the nature, amount and quality of sanctions,¹⁴⁹ but that is not to say that they are unrestrained by rules, regulations and directives. The dilemma is that simply eliminating discretion makes the job more difficult due to complicated situations, responses to unique circumstances and the need to promote clients' self-regard.¹⁵⁰ The solution could be a 'correct balance between compassion and flexibility on one hand, and impartiality and rigid rule application on the other'.¹⁵¹ The problem with discretion in Chinese grassroots tax bureaus is too much compassion, flexibility and even discretion abuse due to inadequate tax laws and limited procedures.

China, as a transitional country, is still on the road towards a consistent and complete tax law system. Most taxes are regulated by administrative regulations made by the State Council instead of laws¹⁵² legislated by the National People's Congress (the highest legislative institution in China) in 1980, 1995 and 2007, respectively,¹⁵³

¹⁴⁹ Michael Lipsky, *Street-Level Bureaucracy: Dilemmas of the Individual in Public Services* (The Russell Sage Foundation 2010) 13, 14.

¹⁵⁰ *ibid* 15.

¹⁵¹ *ibid* 15-16.

¹⁵² Except for the Corporate Income Tax Law, Individual Income Tax Law and Law of PRC on the Administration of Tax Collection.

¹⁵³ Individual Tax Law was amended in 2005, 2007 and 2011; Law of PRC on the Administration of

the legal effects of which are stronger than administrative and local regulations.¹⁵⁴ It is reasonable to make laws based on long-term experimentation. Legalization is costly. However, illegalization makes the law enforcer (the State Council or the SAT) become the rule makers, which leave opportunities for them to protect their interests. For instance, the SAT made a rule called the strict liability of buyers, meaning that whether or not the buyer knows an invoice is illegally issued, they cannot deduct input taxes based on those invoices. This rule gave rise to several disputes among tax authorities because the SAT rule had no legal basis. In 2008, the State Council amended Article 9 of the Interim Regulation of PRC on VAT by introducing the SAT's regulations as a legal basis for verifying illegal VAT input invoices.¹⁵⁵

There were three major organizational reforms within tax authorities. In the 1980s, grassroots tax cadres, also called special managers (專管員), enjoyed the authorities of tax collection, administration and investigation. The nanny tax bureaus visited taxpayers and collected taxes one by one.¹⁵⁶ But there was little resistance

Tax Collection was amended in 2001, 2013 and 2016.

¹⁵⁴ Article 88 of Legislation Law of the PRC, amended in 2015. Administrative regulations are made by the State Council; local regulations are issued by the local People's Congress; rules are formulated by local governments (province, municipality and county)

¹⁵⁵ See Wei Cui, 'Zhongguo shuiwu susong shizheng yanjiu' [The Empirical Study on Tax Administrative Litigations in China] (2015) 9 Qinghua Faxue (Tsinghua University Law Journal) 135, 155; Ji Li, 'Dare You Sue the Tax Collector? An Empirical Study Administrative Lawsuits against Tax Agencies in China' (2014) Pacific Rim Law & Policy 57-112.

¹⁵⁶ SAT, '2002–2006 Nian zhongguo shuishou zhengshou guanli zhanlue guihua gangyao' [The Outline of Strategic Planning on Tax Collection and Administration from 2002–2006] (10 March 2003)

<<http://www.chinatax.gov.cn/n810341/n810765/n812198/n813086/c1207101/content.html>> accessed

because most taxes were collected from collective and state-owned enterprises.¹⁵⁷

With the privatization and the rapid growth of private enterprises in the 1990s, tax authorities started to separate the powers of collection, administration and investigation—that is, the specific department of tax collection was set up for collecting taxes only; the tax branches took charge of routine administration with respect to tax consultants, business registrations, calling in arrears, monitoring, tax assessment and inspection; and the audit bureaus investigated cases of violation of tax laws.¹⁵⁸ In 1997, a further reform ‘centralizing collection, emphasizing checks, intensifying administration on the basis of tax returns and optimized services and by depending on computer networks, and correctly dealing with the relationships among collection, administration and checking’ was initiated to further enhance the separation of the powers.¹⁵⁹

Three reforms improved procedural justice and efficiency but remained ambivalent procedures that often led to discretion abuse. Cui suggested that the existing tax legislations and regulations have empowered tax authorities with too

15 November 2016.

¹⁵⁷ Elizabeth Remick, *Building Local States: China during the Republican and Post-Mao Eras* (Harvard University Press 2004) 140.

¹⁵⁸ The SAT, ‘Guojia shuiwu zongju guanyu jingyibu jiaqiang shuishou zhengguan jichu gongzuo ruogan wenti de yijian’ [Opinions of the SAT Concerning Some Issues on Further Strengthening the Basic Work of Tax Administration] (22 October 2003) <<http://www.chinatax.gov.cn/n810341/n810765/n812198/n813046/c1204889/content.html>> accessed 2 September 2017.

¹⁵⁹ *ibid.*

much discretion.¹⁶⁰ Article 63 of the Law of PRC on the Administration of Tax Collection provides that if a taxpayer evades taxes, the tax authority shall pursue the unpaid or underpaid taxes, the late fee and a fine of an amount from half to five times the taxes unpaid or underpaid. Article 37 of the Provisional Regulations of National Invoice Management prescribes that when someone illegally issues an invoice, the tax authority shall confiscate the illegal gains; if the amount is less than 10,000 RMB, the tax authority may fine no more than 50,000; if the amount is more than 10,000, the fine shall be more than 50,000 and less than 500,000. Articles 38 and 39 also provide a broad scale of fines for illegal invoice behaviours. The 2012 SAT guidance suggested that provincial tax authorities (autonomous regions and municipalities) should formulate the discretion benchmark for regulating various administrative discretions based on local circumstances of law enforcement.¹⁶¹ However, this caused other problems. Firstly, these provincial discretion benchmarks included illegal type, illegal behaviour, legal basis, severity and sanctions, but failed to consider taxpayers' intentions. Secondly, the benchmarks varied between provinces, bringing regional

¹⁶⁰ Wei Cui, 'Zhongguo shuiwu susong shizheng yanjiu' [The Empirical Study on Tax Administrative Litigations in China] (2015) 9 Qinghua Faxue (Tsinghua University Law Journal) 135, 155.

¹⁶¹ The SAT, 'Guojia shuiwu zongju guanyu guifan shuiwu xingzheng cai liang quan gongzuo de zhidao yijian' [Guiding Opinions of the SAT on Regulating the Work of Administrative Discretion for Taxation] (7 March 2012) <<http://en.pkulaw.cn.ezproxy.cityu.edu.hk/display.aspx?cgid=179137&lib=law>> accessed 3 November 2016.

unfairness.¹⁶² Finally, the tax officials were hesitant to apply the criteria because they might incur an enforcement risk when taxpayers come to court.

If taxpayers can exhaust legal remedies for injustice, the discretion of tax authorities can be monitored and regulated. Cui's empirical study showed that administration litigations of taxation reached 2,000 RMB annually at the end of the 1990s, fell to 1,000 in 2004, and has remained at 400 in recent years. Three factors are attributed to the low litigation rate for tax disputes in China. Firstly, the cost of litigation is high: taxpayers should request administrative reconsideration first and pay all their arrears before going to court. Secondly, the tax legislations are inconsistent and incomplete, so that grassroots tax offices enjoy too much discretion. Thirdly, most taxpayers know their cases are not strong enough because they have failed to pay taxes honestly.¹⁶³

Evaluating and Disciplining the Frontline Tax Officials

Tax authorities exercise an annual top to bottom performance appraisal (績效考覈). The upper tax authorities rewarded the lower level tax authorities that ranked highest based on overall performance or on a specific indicator (e.g. organizational revenue performance). The indicators varied every year.¹⁶⁴ In 2012, there were seven

¹⁶² Longlin Qin, 'Shuiwu xingzheng chufa ziyou cailiangquan: Cunzai wenti yu guifan jianyi' [Discretionary Power of Tax Administration Penalty: Issues and Suggestions for Standardization] (2014) *Guoji Shuishou* (International Taxation in China) 58–60.

¹⁶³ Wei Cui, 'Zhongguo shuiwu susong shizheng yanjiu' [The Empirical Study on Tax Administrative Litigations in China] (2015) 9 *Qinghua Faxue* (Tsinghua University Law Journal) 135, 155.

¹⁶⁴ For example, in County J, before 2016, there are 100 points and only seven major indicators; after

indicators involving 24 sub-indicators with a total of 100 points in the province of County J (Table 7). Performance assessment motivated tax authorities to increase revenue by the way of audit, inspection or investigation. For instance, the sub-indicators of investigated arrears read that tax authorities gained two points if the unpaid tax accounted for one per cent of annual revenue and 0.2 points if it was in excess of 0.1 per cent, with a 0.2 point deduction if it was below 0.1 per cent.

Two indicators were used to regulate misconduct and ensure procedural justice during the law enforcement. If tax authorities were brought administrative reconsiderations and litigations, and found illegal behaviours by the SAT, audit bureaus or other financial departments, their points should be deducted. If tax officials committed offences, the organizational points would be reduced.

The upper level tax office not only monitors the task fulfilment progress, but also disciplines irresponsible or illegal acts by the lower level tax office. Managing agents, however, is never easy in most societies, especially in an authoritarian state where rule of law is often lacking.¹⁶⁵ Cai found that the upper level tax office adopted a “selective or differentiated discipline” based on ‘the severity of the consequences of the official’s failure, and his or her role in the failure’.¹⁶⁶ However, if officials are

2016, there are 1,000 points and more than 20 indicators.

¹⁶⁵ Yongshun Cai, *State and Agents in China: Disciplining Government Officials* (Stanford University Press 2014) 181.

¹⁶⁶ Yongshun Cai and Lin Zhu, ‘Disciplining Local Officials in China: The Case of Conflict Management’ (2013) 70 *The China Journal* 98, 119.

able to block the flow of information, their malfeasance will also be hard to find.¹⁶⁷

Embedded in the political and social network, tax officials are able to cover up their malfeasance.

Bureau R was audited by the upper level tax office in August 2015. A work team consisting of three officials from either the municipal tax office or another same level tax office investigated the cases that Bureau R had handled in the previous week. The head of Bureau R had worked in the municipal tax office for seven years and knew all three officials well. The investigation result showed no serious offences but some small violations. These internal investigations were conducted annually. According to the head of Bureau R (R1), none had been sanctioned before. Without external monitoring and a sound rule of law, simply relying on ‘the monitoring of the central or provincial authorities is essentially impossible’.¹⁶⁸

¹⁶⁷ *ibid.*

¹⁶⁸ Yongshun Cai, *State and Agents in China: Disciplining Government Officials* (Stanford University Press 2014) 190.

Table 7. The 2015 Indicators of Performance Evaluations in the State Tax Office of County J

Indicators	Sub-indicators	Points	Percentage	Total	
Organizational revenue	Revenue income	6	6%		
	Accuracy rate of prediction	3	3%		
	Revenue growth and contribution	4	4%		
Tax administration	Tax assessment	9	9%	22%	
	International corporate tax administration	3	3%		
	Anti-tax avoidance	2	2%		
	Export tax refund	5	5%		
	Investigated arrears	4	4%		
	Quality of tax administration	3	3%		
	Corporate income tax administration	3	3%		
	Risk management	2	2%	22%	
	Service of tax payment	Establishment of tax service hall	3	3%	
		Establishment of tax website	2	2%	
Response rate of 12366 hotline		1	1%	6%	
Regulation of law enforcement	Legal administration	3	3%		
	Administrative reconsideration	2	2%		
	Supervision of law enforcement	5	5%	10%	
Technological tax administration	GTP	3	3%		
	Information application	3	3%		
	Model application	3	3%		
	Business creation	2	2%		
	Accuracy rate of data quality	3	3%	14%	
Development of administrative team	Advanced work unit	5	5%		
	Illegal behaviour	12	12%		
	Individual assessment	3	3%	20%	
Budget administration	The budget progress	3	3%		
	Security management	3	3%	6%	
Total		100	100%	100%	

Cost-Benefit Analysis

Economic theory builds on the assumption that actors are naturally self-regarding and oriented towards maximization of their own interests. It assumes that all parties involved in enforcement and regulation seek to maximize their utility;¹⁶⁹ it also assumes that enforcement is costly.¹⁷⁰ The bureaucratic study observed that government officials were ‘purely self-interested’¹⁷¹ or ‘primarily self-interested and highly opportunistic in pursuit of that self-interest’,¹⁷² and were motivated by goals that benefited themselves rather than society.¹⁷³ This assumption especially fits with the grassroots officials in China, the largest authoritarian state around the world where the free press and rule of law are often lacking. A cost-benefit analysis helps us to understand how frontline tax bureaus make decisions on their routine activities.

The Costs of Enforcement

Tax officials’ consideration of cost includes organizational cost and personal cost. In his influential study, Stigler suggested that the extent of law enforcement

¹⁶⁹ George Stigler, ‘The Theory of Economic Regulation’ (1971) 2 *Bell Journal of Economics and Management Science* 3, 21; Baldwin Robert, Martin Cave and Martin Lodge, *Understanding Regulation: Theory, Strategy, and Practice* (Oxford University Press 2012) 43.

¹⁷⁰ George Stigler, ‘The Optimum Enforcement of Laws’ (1974) *Essays in the Economics of Crime and Punishment* 55–67.

¹⁷¹ Anthony Downs, *Inside Bureaucracy* (Scott, Foresman and Company 1967) 88.

¹⁷² Steven Solnick, *Stealing the State: Control and Collapse in Soviet Institutions* (Harvard University Press 1998) 5.

¹⁷³ Yongshun Cai, *State and Agents in China: Disciplining Government Officials* (Stanford University Press 2014) 181.

relies on the amount of organizational resources devoted to the task¹⁷⁴—for instance, professional and technical staff, funds, assessable information, etc. With severer punishments and higher enforcement costs, ‘the marginal deterrence of heavy punishment could be very small or even negative.’¹⁷⁵ Thus, the optimal and rational enforcement is to pursue major offences with heavy penalties instead of minor offences. The optimal tax audit strategy aims to maximize tax and penalty revenues as well as minimizing audit costs.¹⁷⁶

Not only has the enforcement cost (or organizational cost) swayed the decision-making of frontline tax officials, but personal cost has also played a role in China. As discussed before, tax authorities care more about their career safety and are risk averse. Grassroots tax bureaus have paid more attention to meeting the target tax revenue to avoid unnecessary trouble. They have also dealt carefully with the political and social ties between senior members of local government and taxpayers.

The Benefits of Enforcement

Rational actors attempt to maximize utilities. The benefits of enforcement include organizational benefit and personal benefit. The goal of organizational enforcement is to achieve a certain degree of compliance.¹⁷⁷ When the benefits of

¹⁷⁴ George Stigler, ‘The Optimum Enforcement of Laws’ (1974) *Essays in the Economics of Crime and Punishment* 55–67.

¹⁷⁵ *ibid* 3, 21.

¹⁷⁶ James Andreoni, Brian Erard and Johnathan Feinstein, ‘Tax Compliance’ (1998) 36 *Journal of Economic Literature* 818, 860.

¹⁷⁷ George Stigler, ‘The Theory of Economic Regulation’ (1971) 2 *Bell Journal of Economics and*

enforcement are trivial, tax authorities might deviate from enforcement.

Career prospects (e.g. promotion), rewards and social resources are all benefits for frontline tax officials. Tax officials—especially the principals of tax agencies—would like to meet tax revenue targets to show their eligibility, avoid unnecessary troubles and maintain good relations with the local government. Tax officials also benefit from bribery (rent seeking) owing to political or social ties. The discipline from the higher level government or tax offices can reduce the potential benefits of enforcement. It depends on how the tax officials estimate the risks of detection and the severity of sanctions. According to Cai's study, higher level governments or departments often tolerate officials' malfeasance.¹⁷⁸ The effects of top-down monitoring and discipline might be trivial on the mental accounting of benefits among tax officials.

Understanding the logic of decision-making in enforcement has both theoretical and practical significance. The upper left quadrant in Table 8 refers to symbolic enforcement, when both benefits and costs are low. In the bottom left quadrant, weak enforcement happens when the costs are high and the benefits low. The upper right quadrant, creative enforcement, refers to low costs and high benefits, while the bottom right quadrant, negotiated enforcement, refers to high benefits that are costly.

Management Science 3, 21.

¹⁷⁸ Yongshun Cai, 'Disciplining Local Officials in China: The Case of Conflict Management' (2013) 70 The China Journal 98, 119.

Table 8. The Cost and Benefit Decisions of Frontline Tax Officials

		Benefit	
		Low	High
Cost	Low	<i>Symbolic enforcement</i> (Tax promulgation)	<i>Creative enforcement</i> (Collecting tax revenues)
	High	<i>Weak enforcement</i> (Auditing small offences)	<i>Negotiated enforcement</i> (Investigating the case of larger businesses initiated by upper-level tax office)

Symbolic Enforcement

When the costs and benefits were lower, tax officials tended to enforce the task symbolically regarding research papers, tax propaganda, party work and the rest. The following were some tasks of the fifth tax branch of Bureau P in 2016:

Tax promulgation. Gain one point when a propaganda report is adopted by the county tax bureau (maximum four points); deduct one point each when tax branches or departments fail to attend the propaganda project organized by the county tax bureau.

Research work. Gain six points when every tax branch submits at least one good research article or report before 10 May and every department and audit bureau submits at least one before 31 October. Gain another four points when the work is chosen as a significant social and economic issue by leaders or published; deduct two points when tax authorities fail to complete the above activities.

Projects of collection and administration. Based on the arrangements and requirements of the SAT and the provincial tax office, every tax branch,

department and audit bureau submits a study report on the legal system and reform of tax collection and administration, internet-based administration and modernization to the city tax office on time.

Party work. In order to promote President Xi Jinping's talk on family traits, every tax branch should submit an article based on a local family tradition.

Tax promulgation aimed to encourage tax agencies to develop a creative tax service and provide tax information to taxpayers. Publication of reports was in internal tax periodicals. Research work or project studies motivated tax officials to study the latest tax policies, laws or comparative experiences, as well as the problems found in their everyday work. Party work targeted the disciplining of tax cadres and enhancing the party ideology.

All of the above tasks were easier for tax bureaus to implement and irrelevant to external political and social norms. Implementing these tasks gained credit for performance assessment, but the assignments made no difference to the result of the performance evaluation because almost every tax branch and department was able to implement it. Hence, their strategy was to enforce these tasks symbolically. In terms of tax promulgation, the fifth branch of Bureau P asked two tax officials to put a table at the door with a banner reading 'Everyone is obliged to pay tax', then delivered a brochure to the taxpayers. Another official took photos during the activity. They wrote an activity report with illustrations. Bureau R came up with a new solution to promote tax policies. They gathered the taxpayers, who just happened to deal with tax business, to their conference room, showed them a video, delivered a tax brochure

and took photos. Regarding writing a research paper or report, their normal strategy was to copy and paste from online materials.

Symbolic enforcement was commonly used to implement policies, laws or organizational assignments that brought limited benefits for frontline tax branches or departments. In order to fulfil the assignments, tax agencies either forged evidence or indifferently enforced them.

Creative Enforcement

When the costs of a task were low and its benefits were high, tax officials were keen to implement it. They might be motivated to enforce the task creatively to maximize the future benefits. Take the collection of tax revenues as an example. In the 1980s, collecting revenues was costly because tax cadres would visit taxpayers and collect taxes one by one. The two decades of administrative reforms, including computerization, GTP, the hotline service and the like, had significantly reduced tax authorities' costs for collecting tax revenues. On the other hand, collecting sufficient tax revenues brought high benefits. It could improve their performance evaluations at the end of the year. Tax bureaus that were able to meet or exceed their tax revenue target had more opportunity to gain promotions and win bonuses.

The tax revenue target was set based on local economy growth, prior tax revenue targets and the amount of tax revenue in the last year. The municipal tax office predicted the target by estimating the local development plan with respect to new investments and new projects. To illustrate, the harbour developmental zone of

County J invested 7.4 billion RMB to run 19 new projects regarding the chemical industry, infrastructures, harbour facilities and real estate that could contribute around 50 million to the annual revenue in 2013.¹⁷⁹ In 2014, there were 11 new significant projects in which a total of around 11 billion were invested; these were predicted to contribute 150 million to annual revenue.¹⁸⁰ With this information, the municipal tax office was able to predict a rough tax revenue for the coming year. The tax revenue target for the next fiscal year was often higher than the one for the last year. Bureau R, for example, was assigned tax revenue targets of 200 million,¹⁸¹ 230 million, 500 million and 990 million from 2012 to 2015, respectively, by the municipal tax office. The tax revenue targets of Bureau P increased by 33.66 per cent on average every year from 2006 to 2012.¹⁸²

There were two types of target: the municipal tax office and the county government. The municipal tax office emphasized the previous tax revenue more, while the county government focused more on expenditure and the fiscal balance. Therefore, the tax revenue target that was required by the county government tended to be higher. Table 9 and Table 10 show the tax revenue target and tax revenue in

¹⁷⁹ The Analysis of Tax Revenue of Bureau R in January 2013.

¹⁸⁰ See *Economic Report* made by The Government of Harbour Developmental Zone of County J in December 2014.

¹⁸¹ It was revised in December 2012.

¹⁸² Its tax revenue target increased by 45.3 per cent in 2007, 32.79 per cent in 2008, 38.18 per cent in 2009, 18.42 per cent in 2010, 35.8 per cent in 2011 and 32.45 per cent in 2012. I calculated the revised tax revenue targets.

Bureau R (county-level local tax bureau) and Bureau P (county-level state tax bureau). There were three possible scenarios when implementing the tax revenue target: meeting the target, being unable to meet the target, and finding the target somewhat difficult to meet.

Table 9. Tax Revenue Target and Tax Revenue in Bureau P (2006–2015) (Millions, RMB)

Year	Tax revenue	The municipal tax office				The county government			
		Original target	Task completion ratio (%) (before revision)	Revised target	Task completion ratio (%) (after revision)	Original target	Task completion ratio (%) (before revision)	Revised target	Task completion ratio (%) (after revision)
2006	172.43	142.5	121.00%	N/A	121.00%	153.3	112.48%	N/A	112.48%
2007	236.79	207.1	114.34%	N/A	114.34%	214.52	110.38%	N/A	110.38%
2008	311.1	275	113.13%	N/A	113.13%	310	100.35%	N/A	100.35%
2009	390.1	335	116.45%	380	102.66%	365	106.88%	N/A	106.88%
2010	494.87	405	122.19%	N/A	122.19%	456.7	108.36%	N/A	108.36%
2011	637.32	550	115.88%	N/A	115.88%	625.8	101.84%	N/A	101.84%
2012	764.04	723	105.68%	N/A	105.68%	831	91.94%	750	101.87%
2013	865.07	1020.4	84.78%	860	100.59%	1019.8	84.83%	850	101.77%
2014	889.27	1411	63.02%	883	100.71%	1400	63.52%	865	102.81%
2015	895.68	1086	82.48%	830	107.91%	1129	79.33%	820	109.23%

Table 10. Tax Revenue Target and Tax Revenue in Bureau R (2012–2015) (Millions, RMB)¹⁸³

Year	Tax revenue	The municipal tax office				The county government			
		Original target	Task completion ratio (%) (before revision)	Revised target	Task completion ratio (%) (after revision)	Original target	Task completion ratio (%) (before revision)	Revised target	Task completion ratio (%) (after revision)
2012	200.00	300.00	66.67%	200	100.00%	Missing	Missing	Missing	Missing
2013	370.00	230.00	160.87%	N/A	160.87%	300.00	123.33%	N/A	123.33%
2014	980.00	500.00	196.00%	N/A	196.00%	550.00	178.18%	N/A	178.18%
2015	990.00	990.00	100.00%	N/A	100.00%	950.00	104.21%	N/A	104.21%

¹⁸³ Bureau R was established in 2012.

Fulfilling the Tax Revenue Targets and Controlling the Amount

Bureau P was able to meet the tax revenue target required by the municipal tax office and the county government without any revisions from 2006 to 2011. Tax authorities monitored the progress of target implementation monthly. In June, they examined the outcome for the half year. The analysis of tax revenues in June of 2006 and 2010 read:¹⁸⁴

In the first half year, due to the excellent economic performance, we collected 77.64 million RMB. It accounted for 54.48 per cent of the tax revenue target assigned by the municipal tax office. We achieved the goal of “double half” (雙過半) (that target was half accomplished when the time passed half).

We collected 250 million RMB, 61.14 per cent of a total of 410 million annual target. It was completed 21 days earlier than the plan.

The tax revenue target mechanisms, however, brought undesired outcomes. If the county tax bureau and its tax branches met the tax revenue target before December, they tried to control the amount of tax revenue by asking some larger companies to stop issuing *fapiao*, or by paying part of the tax in the coming January. This strategy was used to keep a lower tax revenue target for the next year. For instance, the accountant for a local larger company explained (Z1):

¹⁸⁴ Similar statements were written in the analyses of tax revenues for Bureau P from 2007 to 2009.

Tax officials called our financial manager to stop issuing *fapiao* until the end of the December because they had met the tax revenue target. This is very common. Larger companies liked to cooperate with tax agencies. They tried to control the amount to obtain a smaller tax revenue target in the next year. The lower the target, the less the pressure.

Unable to Fulfil the Tax Revenue Targets

Sometimes, tax agencies were unable to collect sufficient tax revenues as a result of mistaken prediction or unanticipated incidents. Bureau R was allocated a tax revenue target of 300 million RMB at the beginning of 2012. However, it had only collected a total of 210 million in November because some significant projects were not accomplished on schedule. Obviously, it was impossible for Bureau R to collect 90 million during the remainder of the year. The municipal local tax office then changed the target to 200 million so that Bureau R could just meet the target (Table 10). The targets for Bureau P were revised from 2012 to 2015. Figure 10 shows that Bureau P exceeded the target slightly after it was adjusted.

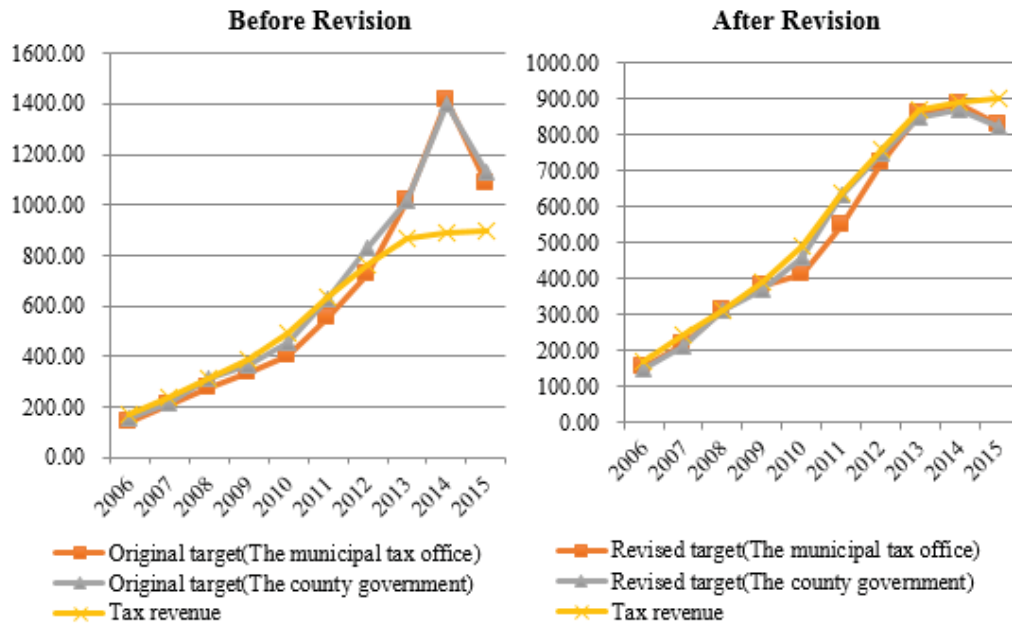


Figure 10. Before and After Revision of Tax Revenue Target in Bureau P (2006–2015)
(Millions, RMB)

Why did the municipal tax office approve the revision? It was because the county government tried to beautify the annual performance. The leader of the county government mobilized the municipal tax office to reduce the tax revenue target. Informal political and social networks played roles during the negotiation. The municipal tax office would examine whether the target assigned by the provincial tax office could be completed. If it could, they would increase the targets for the developed counties and reduce the targets for the underdeveloped counties. All parties favoured this win-win outcome. That pattern was duplicated at different levels of government and tax offices.

Somewhat Difficult to Fulfil the Tax Revenue Targets

When it was a bit hard to meet the tax revenue target on time, tax bureaus might either seek help from the local larger businesses or audit a company that was

suspected of evading taxes. To reduce the enforcement cost, tax officials required the taxpayers to self-check. If taxpayers found something wrong with their tax return, they would pay arrears. This was so-called self-correction. However, if taxpayers failed to check themselves properly, tax officials would investigate on the spot. They normally preferred medium or larger state-owned businesses.

Weak Enforcement

When the costs of an enforcement were high while its benefits were low, tax agencies had no motivation to enforce it. To illustrate, tax agencies avoided detecting small offences which were difficult to find. According to Stigler's optimum enforcement of laws, 'The state will pursue more tenaciously the offender who commits a larger crime (or repetitive crimes) and thus increase also the probability of apprehending him.'¹⁸⁵ Combatting tax evasions by small and medium-sized companies required more manpower, financial resources, information and so forth. It was also risky for tax agents as the law enforcement could break their political and social network, which might bring high personal cost.

On the other hand, detecting small or minor offences achieved little compliance. The vice-chief of the fifth tax branch of Bureau P (P2) said:

There are six tax branches with approximately forty tax officials in Bureau P.

Some of them lack specialized tax knowledge and some of them are too

¹⁸⁵ George Stigler, 'The Theory of Economic Regulation' (1971) 2 Bell Journal of Economics and Management Science 3, 21.

young to have experience of audit. Except for them, there are only twenty experienced auditors. Some tax evasions are very difficult to find. The cash economy is everywhere in China. It is useless to detect those evasions if everyone disobeys the law. You stop one, others continue.

The chief of the first tax branch of Bureau P (P3) further explained:

The larger the size of the companies, the better compliance they have.

Firstly, larger companies should build up a transparent information system, so they should comply with the law voluntarily. Otherwise, they are also easy to detect... Secondly, every company experiences the stages of youth and maturity. In their young age, they are struggling to survive so they are often unable to pay tax; when they become mature, they care more about their social status and reputation. They also enjoy more political and economic benefits—for example, tax relief, project support and funding.

Compared with larger companies, small and medium-sized companies contributed a small amount of revenue to tax bureaus. The major revenue resource for Bureau R was the property industry. Except for BT (43.96 per cent), land use tax, property tax, VAT on land, tax on farmland occupation and deed tax (16.81 per cent) were all related to the real estate industry. The taxes levied from the architecture industry and real estate accounted for 88.22 per cent of the annual tax revenue from 2012 to 2015. Larger businesses contributed 83.27 per cent to the tax revenue. Heavy reliance on the real estate industry in local government was not new in China. Zhou

suggested that grassroots governments uphold urbanization because they earn revenues through developing the real estate industry.¹⁸⁶ In Bureau P, ten larger companies whose annual amount of tax payment exceeded 10 million RMB paid 38.7 per cent of the annual tax revenue; in addition, around 130 medium and larger companies whose annual amount of tax payment exceeded 1 million provided 75.96 per cent of the annual revenue from 2010 to 2015. In all, Chinese tax revenue was largely levied from larger businesses and concentrated on one or two significant industries. More supervision and audits on small and medium-sized companies made little difference to the total tax revenues, as did individual career prospects.

To avoid non-enforcement, some indicators of performance assessment were added to encourage the frontline tax agents to investigate tax evasions. The greater the audit revenue, the higher the points. In practice, the mechanisms preventing tax officials from weak enforcement were largely ineffective but brought new problems. Tax agencies came up with auditing selectively based on the amount of possible arrears payment, belated payment and fines.

Negotiated Enforcement

When the costs and benefits of enforcement were high, tax bureaus preferred negotiation to balance the interests of the different parties. The new risk-based audit system might allocate the auditing of large businesses. The national campaign of

¹⁸⁶ Feizhou Zhou, 'Fenshuizhi shinian: Zhidu ji qi yingxiang' [A Decade of Division of Taxes: The System and Its Influence] (2006) 6 Social Sciences in China (Zhongguo Shehui Kexue) 100, 117.

combatting illegal VAT invoices might also lead the audit to some medium and large businesses. Auditing medium or large businesses brought high costs and benefits. Firstly, the audit process demanded more professional and experienced tax officials as the large businesses had more complicated business styles, markets and organizations. What was more, large businesses' tax payments were significant in relation to revenue performance. If they were punished, both reputation and business were damaged. Detection of large companies, therefore, was faced with political and social pressures from the local government. In contrast to higher organizational and personal costs, the detection could also bring high benefits to the tax authorities. On the one hand, it could achieve more compliance in local communities if the large businesses were audited and punished. On the other hand, large businesses would mobilize their political resources to avoid audit and punishment. Tax agents were able to accept bribes from wealthy businesses. A win-win strategy—i.e. negotiated enforcement—was thus adopted.

X Company, established in 1995, administered by the second tax branch of Bureau P,¹⁸⁷ produced quick-frozen products and exported to other countries. Its tax payment reached 9.55 million RMB in 2015. The audit bureau started to investigate X Company's 2014–2015 tax return in early 2016. It found that X Company evaded

¹⁸⁷ The second tax branch of Bureau P majorly governed export enterprises.

0.01 million of VAT and 0.5 million of corporate income tax. Besides paying arrears, the company was also fined.¹⁸⁸

14. According to Article 64, Law of PRC on the Administration of Tax Collection, ‘When a taxpayer does not file tax returns, or does not pay or underpays the taxes, the tax authority shall pursue the payment of the taxes unpaid or underpaid and the belated fee, and fine with the amount from 50 per cent to five times of the taxes unpaid or underpaid’.¹⁸⁹ We suggest a fine of 50 per cent of VAT unpaid. That is $5677.43 = (2717.68 * 0.5 + 8637.17 * 0.5)$.

15. According to Article 32, Law of PRC on the Administration of Tax Collection, ‘When a taxpayer fails to pay taxes or a withholding agent fails to remit taxes within a prescribed time limit, the tax authority shall, in addition to ordering the taxpayer or withholding agent to pay or remit the taxes within the prescribed time limit, impose a belated fee at the rate of 0.05 per cent per day of the amount of taxes in arrears, on the day the tax payment is overdue.’¹⁹⁰ X Company should pay the belated fee.

¹⁸⁸ Tax Audit Report of the Case of X Company, issued in 2016.

¹⁸⁹ The translation is from Fabao database, Peking University <<http://en.pkulaw.cn.ezproxy.cityu.edu.hk/display.aspx?cgid=252598&lib=law>> assessed accessed 18 November 2016.

¹⁹⁰ The translation is from Fabao database, Peking University <<http://en.pkulaw.cn.ezproxy.cityu.edu.hk/display.aspx?cgid=252598&lib=law>> accessed 18 November 2016.

Based on the above decisions, X Company should pay arrears, the belated fee and fines. The fine would be recorded in the file and the information was public. For an export company, it could damage its reputation, as well as slow the export VAT refund. Thus, X Company sought help from the local government. X Company's application and the reply from the vice president of the county below show how the audit decision was changed.

Application for Pleading with the Tax Audit Case of X Company

County Government:

X Company is the provincial leading enterprise of the ocean and agricultural industry. The annual amount of export sales reaches 45 million USD. The company paid a total of 11 million RMB annually.¹⁹¹ X Company will soon obtain a well-known trademark of China due to the stable development in recent years. In the special inspection of aquatic products from 2014 to 2015, the audit bureau found illegal records in the accounting books. X Company has regulated its finance and taxation operation under the instruction of the audit bureau. It was required to pay 0.50 million for the arrears of corporate income tax, 0.01 million for the VAT arrears, and 5677.43 for fines. The record of the penalty will lower our credit level of export tax refunds, and have a bad impact on the credit level of finance at the bank. To support local

¹⁹¹ The amount of tax payment here was more than the amount I collected from County J. It might be because X Company included the amount of export refund.

enterprises, X Company earnestly requests county government to put good words in front of the county state tax office. We wish that we can be exempted from the fines.

In the margin of the report, the vice president of the county government wrote to the county-level state tax office:

X Company is one of the top ten export enterprises in the county. If the company is fined, its export will be affected on the one hand, and the county might also fail to meet the revenue target on the other hand. Please support the company.

Negotiated enforcement means that the audited taxpayers and tax authorities negotiate the penalties of illicit behaviours. After negotiation, the tax authorities reduced the sanctions. Tax officials or the chief of the tax bureau gave *renqing* (help) to the leaders of the local government and the owner of the company. They could get *renqing* back in the future when tax bureaucrats also needed help from them. It is a good way to build up a political network.

Negotiated enforcement, however, has potential risks—for example, when the higher tax office or the SAT oversaw the case, tax officials and the chief of the audit bureau would be punished because the negotiated enforcement actually violated the tax law. Thus, the chief of the audit bureau and the president of Bureau P might prefer to submit these risky cases to the higher level audit office. The chief of the audit bureau in Bureau P (P8) gave an example:

Last year, a large company tried hard to persuade us not to be convicted of illegally issuing invoices. I reported it to the president. Considering the enforcement risk, we transferred the case to the city tax office.

A tax official in Bureau R (R4) expressed a similar worry:

There are too many discretions. Last year, I audited a state-owned enterprise and found that it evaded nearly one million. The county government asked the company to pay the arrears. Then they also negotiated on the amount of belated fee. In fact, we have faced high enforcement risks when the higher tax office checks the quality of law enforcement.

The Pattern as a Tool to Organize Previous Studies

Tax officials made decisions based on their mental calculations of the costs and the benefits. The cost dimension consists of the need for manpower, financial resources and facilities support, as well as the possibility of being removed from position and of losing social capital—i.e. *guanxi*. The benefit dimension includes the organizational benefits that increase the tax revenues and voluntary compliance of the local community, and the individual benefits of gaining promoted, accepting bribes or gaining social capital. I incorporated organizational, legal and social factors to operationalize the costs and benefits of enforcement. The two dimensions work together to shape the decisions of the frontline tax officials. Compared with Stigler's optimum enforcement of laws which only consider the organizational cost,¹⁹² this

¹⁹² George Stigler, 'The Theory of Economic Regulation' (1971) 2 Bell Journal of Economics and

typology will be more applicable and complete to explain the uneven enforcement in an authoritarian state where the rule of law is underdeveloped and state capacity is limited. The typology can also be used to explain previous studies on law enforcement in China.

He's study on migrant businesses in Zhejiang village in Beijing suggested that the state undertook sporadic campaigns to prevent licence violations from getting worse, but not to eliminate them; the state benefited.¹⁹³ The decision was shaped by the conflict of interest between the upper level government, which concerned more on social stability, and the lower level government, which focused on immediate interest.¹⁹⁴ Hence, these sporadic campaigns fall under creative enforcement in my typology, where the costs of the action were low while the benefits were high. This happened when the lower level officials were required to regulate the business in a short period, which was not costly, and they were able to extract interest from the migrant businesses. However, they soon turned to weak enforcement because they knew that eliminating migrant businesses would reduce their benefits and the enforcement costs would become high. The failure of the sporadic campaign,¹⁹⁵ ad

Management Science 3, 21.

¹⁹³ Xin He, 'Why Do They Not Obey the Law? A Case Study of a Rural-Urban Migrant Enclave in China' (JSD thesis, Stanford University 2003) 199.

¹⁹⁴ *ibid* 158.

¹⁹⁵ See Xin He, 'Sporadic Campaigns as a Means of Social Control' (2003) 17 *Columbia Journal of Asian Law* 121, 145.

hoc enforcement¹⁹⁶ or campaign style enforcement¹⁹⁷ can be understood under my typology.

Another strand of studies found that targets played a critical role in shaping the decisions of legal officials. Kostka categorized policy outcomes for China abiding by environmental targets based on whether the outcomes were desirable and anticipated.¹⁹⁸ In my case, I also argue that the local tax officials concentrated more on fulfilling the tax revenue target, the outcome of which could be anticipated and was desirable for the upper level tax office, while they side-lined other targets, the outcome of which could be anticipated but was undesirable. This caused other unintended and undesirable consequences—for example, engaging in statistical inflation. Of course, the target system also generated some unintended and desirable outcomes, like enhancing local tax compliance. The two typologies thus interacted. My typology, however, provides the logic of how different consequences were generated, while Kostka only provided the outcomes.

In short, some of the major theories discussed in previous research on enforcement would gain from considering them within my typology and the interaction of the costs and the benefits. While many existing theories narrow their

¹⁹⁶ See Benjamin Van Rooij, *Regulating Land and Pollution in China: Lawmaking, Compliance, and Enforcement; Theory and Cases* (Leiden University Press 2006) 352.

¹⁹⁷ Nicole Ning Liu, Carlos Wing-Hung Lo, Xueyong Zhan and Wei Wang, ‘Campaign-Style Enforcement and Regulatory Compliance’ (2014) 75 *Public Administration Review* 85, 95.

¹⁹⁸ Genia Kostka, ‘Command without Control: The Case of China’s Environmental Target System’ (2016) 10 *Regulation & Governance* 58, 74.

applications so as to focus on a specific aspect of enforcement problems, my typology can be more broadly applied.

Conclusions

This chapter examines the decision-making process of the frontline tax bureaus in China. It suggests that fiscal pressures, political networks and a flawed legal system have shaped the frontline tax bureaucrats' considerations on costs and benefits.

When the costs and benefits were low, tax agencies tended to symbolically enforce the task. Symbolic enforcement, however, wasted organizational resources, led to dishonesty and neglected important work that might not favour grassroots tax authorities.

Tax agencies paid more attention to meeting their tax revenue targets, since this incurred fewer costs but brought substantial benefits. When the amount of tax payment was high, tax agencies and local governments might control the amount of revenue by requiring the large businesses to implement this year's tax liability in the next year. When tax revenue was unable to meet the target, local governments tried to mobilize the municipal tax office to lower the target in order to enhance the performance record. When tax revenue targets were somewhat difficult to implement, tax agencies or local governments might seek help from the larger businesses to pay taxes in advance, or audit taxpayers about whom they were suspicious. Focusing on the performance evaluation, tax authorities did not maximize tax revenue; instead, they controlled the amount of tax revenue.

Furthermore, tax authorities were not motivated to detect tax evasions since the costs were high and benefits were low. Even though tax authorities had revised the evaluation indicators of organizational performance, introduced risk-based responsive regulation and launched annual campaign regulations on illegal tax invoices, it remained hard to enhance the motivation for detecting small violations.

The study has also revealed that tax authorities negotiated penalties with taxpayers and the local government when the larger businesses were audited. Sanctions like belated fees, fines and criminal sentences were regarded as bargaining chips for tax agencies to establish their political network. If the negotiation had an obvious enforcement cost, tax authorities were more likely to pass the cases to the higher tax office.

This chapter suggests that the frontline tax officials preferred more measurable and quantitative work—for example, annual tax revenue targets—while they were demotivated to implement qualitative targets like auditing local businesses. Moreover, information asymmetry made the higher level tax offices and the SAT unable to recognize the illegal behaviours of tax agencies.¹⁹⁹

The cost-benefit analysis leads to four decisions for frontline tax officials: symbolic enforcement, creative enforcement, weak enforcement and negotiated enforcement. It helps us to understand what has shaped the tax law enforcement in

¹⁹⁹ Shaoguang Wang and Angang Hu, *Zhonghuo guojia nengli baogao [Report of Chinese State Capacity]* (Liaoning Publisher 1993) 26; Genia Kostka, 'Command without Control: The Case of China's Environmental Target System' (2016) 10 *Regulation & Governance* 58, 74.

China, as well as why tax evasions are prevalent even though numerous efforts have been made to enhance enforcement. My pattern is shown to be more applicable to understand the problems of law enforcement in China.

The study also suggests that to discipline frontline tax officials is never easy since most are constrained in a vicious circle. Only when the institutional environment is changed can the outcome of law enforcement be substantially enhanced.

Chapter Three. The Divergent Structural Opportunity to Evade

Having explored how tax law has been enforced in the frontline tax offices, this chapter attempts to broaden the understanding of variations in compliance levels by speculating about the factors that increase or reduce the structural opportunity to evade in southeast China.

Of 65 companies, 29 had higher structural opportunity to evade while 36 had lower structural opportunity to evade. What explains the divergent opportunity to evade among private businesses in southeast China? What has made the opportunity to evade higher? To block the illegitimate opportunity to evade, China has initiated several administrative and organizational reforms, like implementing the GTP, computerizing the report of tax returns, introducing risk-based regulation and launching annual campaigns. How do these reforms work on the opportunity to evade?

The study of structural opportunity to evade is different from classical deterrence theory that only focuses on the sum of detection apprehension and sanction severity. Van Rooij, for example, suggested that ‘such risk should not just emanate from the state and its sanctions, but arises out of multiple sources—state, market, and society.’²⁰⁰ Studying structural opportunity to evade allows us to incorporate more

²⁰⁰ Benjamin Van Rooij, ‘Weak Enforcement, Strong Deterrence: Dialogues with Chinese Lawyers about Tax Evasion and Compliance’ (2016) 41 *Law & Social Inquiry* 306.

recognizable economic, social and legal factors that block or open the opportunity to evade for business taxpayers. Tax authorities could also benefit from the findings.

Social and Institutional Structural Opportunity to Evade

As a proximate and situational factor,²⁰¹ the structural opportunity to evade appears to be the most important factor in shaping compliance rates.²⁰² It can be defined as any structural characteristics of economic, social and institutional situations that hinder the flow of information about deviant acts to be caught or punished.²⁰³ According to Kagan:

When law violations occur in private places, as they often do, they are in an immediate sense invisible to law enforcement officials. The officials can “see” them only if (a) private victims or complainants become aware of the violations and call enforcement officials or file legal claims against the perpetrators, or (b) the government invests in costly and intrusive search or surveillance operations.²⁰⁴

²⁰¹ Daniel Nagin and Raymond Paternoster, ‘Enduring Individual Differences and Rational Choice Theories of Crime’ (1993) 27 *Law & Society Review* 467, 496,

²⁰² Robert Kagan, ‘On the Visibility of Income Tax Law Violations’ in Roth Jefferey and John Scholz (eds), *Taxpayer Compliance Volume 2: Social Science Perspective* (University of Pennsylvania Press 1986) 76, 125.

²⁰³ Loretta Stalans, Kent Smith and Karyl Kinsey, ‘When Do We Think About Detection? Structural Opportunity and Taxpaying Behavior’ (1989) 14 *Law & Social Inquiry* 481, 503.

²⁰⁴ Robert Kagan, ‘On the Visibility of Income Tax Law Violations’ in Roth Jefferey and John Scholz (eds), *Taxpayer Compliance Volume 2: Social Science Perspective* (University of Pennsylvania Press 1986) 78.

Inspired by Kagan's statement quoted above, structural opportunity can be understood from two perspectives: social and institutional opportunity. The 'immediate sense of invisibility' and third party complainants refer to the social opportunity to evade. Legal authorities' detection is associated with institutional opportunity. The two dimensions help us to interpret the divergent structural opportunity to evade in China. Scores of scholars have worked in these two dimensions, though some of them might not be aware that their concepts can be incorporated into one or both.

A number of demographic and social characteristics are related to non-compliance. The 1985 statistics data from the Internal Revenue Service in the USA indicated that married filers under 65 years old were much more likely to evade taxes than their counterparts.²⁰⁵ Compliance rates also differed across occupations. Those people who engaged in sales understated taxes by the largest percentage, and business taxpayers in finance, real estate and insurance understated taxes by the lowest percentage.²⁰⁶ Cloward and Ohlin suggested that if access to education, employment and a good community environment were blocked and illegitimate opportunities to achieve lawbreaking were open, youths turned to delinquency.²⁰⁷ In his study, Tyler also found that sex, age, income and education exerted a significant influence on

²⁰⁵ James Andreoni, Brian Erard and Johnathan Feistein, 'Tax Compliance' (1998) 36 *Journal of Economic Literature* 818, 860.

²⁰⁶ *ibid* 840.

²⁰⁷ Richard Cloward and Lloyd Ohlin, *Delinquency and Opportunity: A Theory of Delinquent Gangs* (The Free Press 1960).

compliance.²⁰⁸ Besides the social demographic, other structural changes influence violations, too. Cohen and Felson's 'routine activity approach' argued that 'the dispersion of activities away from households and families increases the opportunity for crime and thus generates higher crime rates'.²⁰⁹

With respect to business taxpayers, size of firm, particular market niche, economic performance, sector, life course of firm,²¹⁰ to name a few, are important determinants of compliance. For example, small firms and highly competitive markets are more likely to engage in environmental violations.²¹¹ The 'particular market niche—the kinds of goods hauled, how far, and what service and price package its customers wanted most', 'the general market—how well the economy is doing, the price of fuel, and the price of labour where the company operates', and the 'company-level financial condition' also mattered.²¹² These aspects were not dissimilar to Makkai and Braithwaite's opportunity for violations in nursing homes, which referred

²⁰⁸ Tom Tyler, *Why People Obey the Law* (Yale University Press 1990) 59.

²⁰⁹ Lawrence Cohen and Marcus Felson, 'Social change and Crime Rate Trends: A Routine Activity Approach' (1979) 44 *American Sociological Review* 588, 608.

²¹⁰ Erik Stam and Frank Verbeeten, 'Tax Compliance over the Firm Life Course' (2017) 35 *International Small Business Journal* 99, 115.

²¹¹ Dorothy Thornton, Robert Kagan and Neil Gunningham, 'When Social Norms and Pressures are Not Enough: Environmental Performance in the Trucking Industry' (2009) 43 *Law & Society Review* 405, 436.

²¹² *ibid* 422.

to ‘the resources (money, supplies, staff) available to the director of nursing’,²¹³ and Fjeldstad and Semboja’s ‘ability to pay’.²¹⁴

Tax advisors and whistleblowers might provide less or more opportunity for taxpayers to evade taxes. As information brokers, middlemen or intermediaries whose job is to cope with the complexity of tax laws and reduce the compliance cost, tax specialists play a critical role in enhancing compliance.²¹⁵ They must, however, retain and expand client interest and please the customer to increase profits.²¹⁶ Some studies reported evidence that the average level of non-compliance is higher when returns are prepared with the help of tax practitioners than in self-prepared tax returns.²¹⁷ Some existing empirical findings supported both conflicting roles.²¹⁸ Klepper and Nagin, for example, suggested that ‘preparers contribute to compliance by enforcing legally clear

²¹³ Toni Makkai and John Braithwaite, ‘Criminological Theories and Regulatory Compliance’ (1991) 29 *Criminology* 191, 220.

²¹⁴ Odd-Helge Fjeldstad and Joseph Semboja, ‘Why People Pay Taxes: The Case of the Development Levy in Tanzania’ (2001) 29 *World Development* 2059, 2074.

²¹⁵ See Betty Jackson and Valerie Milliron, ‘Tax Preparers: Government Agents or Client Advocates?’ (1989) 167 *Journal of Accountancy* 77, 82; Brian Erard, ‘The Impact of Tax Practitioners on Tax Compliance: A Research Summary’ (1990 IRS Research Conference).

²¹⁶ Elea Wurth, *A Will and a Way: An Analysis of Tax Practitioner Preparation Compliance* (DPhil thesis, The Australian National University 2012) 28.

²¹⁷ See Steven Kaplan, Philip Reckers, Stephen West and James Boyd, ‘An Examination of Tax Reporting Recommendations of Professional Tax Preparers’ (1988) 9 *Journal of Economic Psychology* 427, 443; France Ayres, Betty Jackson and Peggy Hite, ‘The Economic Benefits of Regulation: Evidence from Professional Tax Preparers’ (1989) 64 *The Accounting Review* 300, 312.

²¹⁸ See Kristina Murphy, ‘Aggressive Tax Planning: Differentiating Those Playing the Game from Those Who Don’t’ (2004) 25 *Journal of Economic Psychology* 307, 329.

requirements but also contribute to non-compliance'.²¹⁹ Taxpayers might accept a preparer's recommendation for aggressive evasion.²²⁰

Whistleblowers also reduce the social opportunity to evade. Van Rooij's study on tax evasion among lawyers revealed that lawyers were afraid of clients' complaints and state sanctions when they handled signal cases.²²¹ Tax authorities might encourage citizens to report tax cheats by rewarding them.²²² Qui tam lawsuits, which allow whistleblowers to bring claims to the court and get rewards where the government recovers funds lost to fraud, are adopted to encourage private enforcement. Since the effect of the whistleblower system is limited in China, I will ignore it here.²²³

²¹⁹ Steven Klepper and Daniel Nagin, 'The Role of Tax Preparers in Tax Compliance' (1989) 22 *Policy Sciences* 167, 194.

²²⁰ See Peggy Hite and Gary McGill, 'An Examination of Taxpayer Preference for Aggressive Tax Advice' (1992) 45 *National Tax Journal* 389, 403; Mei Tan Lin, 'Taxpayers' Preference for Type of Advice from Tax Practitioner: A Preliminary Examination' (1999) 20 *Journal of Economic Psychology* 431, 447.

²²¹ Benjamin Van Rooij, 'Weak Enforcement, Strong Deterrence: Dialogues with Chinese Layers about Tax Evasions and Compliance' (2016) 41 *Law & Social Inquiry* 288, 310.

²²² Robert Kagan, 'On the Visibility of Income Tax Law Violations' in Roth Jefferey and John Scholz (eds), *Taxpayer Compliance Volume 2: Social Science Perspective* (University of Pennsylvania Press 1986).

²²³ The table below indicates the number of complainants and whistleblowers from 2009 to 2014. It shows that on average 0.86 per cent of investigated taxes and fines were from reporters. The report percentage from companies was 10.48 per cent and from competitors was 6.72 per cent.

The institutional opportunity to evade refers to loopholes in the legal system, weak legal control and any opportunity provided by the government that can increase the overall opportunity for deviance. The legal design, of course, will influence compliance. Bergman showed that an important similarity between the VAT reforms in Chile and Argentina was that they both reduced several potential loopholes in the tax system.²²⁴ A number of earlier studies focus on audits and sanctions.²²⁵ For example, in an experimental study, taxpayers increased their tax payments significantly after they were informed that their tax return files would be closely examined.²²⁶ Except for audit-based enforcement, other mechanisms could also

The Overview of Report (2009–2014)

Year	No. of report	% of investigation	Amount of investigated tax and fines/Total amount of investigated tax and fines	% of report from company	% of report from competitors
2009	50683	80.17%	1.13%	12.14%	8.82%
2010	42411	69.81%	0.97%	12.51%	7.23%
2011	40466	69.89%	0.97%	11.16%	6.23%
2012	36669	63.32%	0.82%	10.95%	6.55%
2013	44413	59.39%	0.58%	7.89%	5.12%
2014	34169	66.27%	0.70%	8.24%	6.36%
Average	41468.5	68.14%	0.86%	10.48%	6.72%

Source: China Taxation Auditing Yearbook (2010–2015).

²²⁴ Marcelo Bergman, ‘Tax Reforms and Tax Compliance: The Divergent Paths of Chile and Argentina’ (2003) 35 *Journal of Latin American Studies* 593, 624.

²²⁵ See Michael Allingham and Agnar Sandmo, ‘Income Tax Evasion: A Theoretical Analysis’ (1972) 1 *Journal of Public Economics* 323, 338; Steven Klepper and Daniel Nagin, ‘Tax Compliance and Perceptions of the Risks of Detection and Criminal Prosecution’ (1989) 23 *Law & Society Review* 209, 240.

²²⁶ Joel Slemrod, Marsha Blumenthal and Charles Christian, ‘Taxpayer Response to an Increased Probability of Audit: Evidence from a Controlled Experiment in Minnesota’ (2001) 79 *Journal of Public Economics* 455, 483.

reduce the opportunity to evade. For example, non-compliance is lowest when taxes are withheld at source, becomes greater when transactions are subject to information reporting, and is greatest when transactions are conducted in cash.²²⁷ Reducing the cost of compliance can also reduce the institutional opportunity to evade.²²⁸ For instance, improving the service and providing an efficient reporting system for taxpayers can effectively reduce the cost of compliance and thus enhance tax compliance.

This chapter examines the influence of social and institutional opportunity on tax compliance, and how they work together to shape the overall structural opportunity to evade. It finds that divergence of opportunity is the result of an interaction between social and institutional opportunity. The particular institutional context will enhance divergence, which is counterproductive in improving compliance.

²²⁷ See Ann Witte and Diane Woodbury, 'The Effect of Tax Laws and Tax Administration on Tax Compliance: The Case of the U.S. Individual Income Tax' (1985) 38 *National Tax Journal* 1, 13; Robert Kagan, 'On the Visibility of Income Tax Law Violations' in Roth Jefferey and John Scholz (eds), *Taxpayer Compliance Volume 2: Social Science Perspective* (University of Pennsylvania Press 1986) 82; Loretta Stalans, Kent Smith and Karyl Kinsey, 'When Do We Think About Detection? Structural Opportunity and Taxpaying Behavior' (1989) 14 *Law & Social Inquiry* 481, 503; Bernadette Kamleitner, Christian Korunka and Erich Kirchler, 'Tax Compliance of Small Business Owners' (2012) 18 *International Journal of Entrepreneurial Behavior & Research* 330, 351;.

²²⁸ Marsha Blumenthal and Joel Slemrod, 'The Compliance Cost of the US Individual Income Tax System: A Second Look after Tax Reform' (1992) 45 *National Tax Journal* 185, 202; Joel Slemrod and Varsha Venkatesh, 'The Income Tax Compliance Cost of Large and Mid-Size Businesses' (2002) 914 *Ross School of Business Working Paper Series Working Paper* <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=913056> accessed 2 December 2017.

The Social Opportunity to Evade

Natural Visibility of Businesses

Size of firms, market niche, sector and form of business, to name a few, provide legitimate or illegitimate social opportunities to evade. Table 11 reveals the relationship between compliance level and the components of natural opportunity to evade. It shows that medium and larger sized companies tend to have higher compliance than small companies. A more regulated market leads to higher compliance while a less regulated market leads to lower compliance. Manufacturing businesses appear to be more compliant, while service and trade businesses are less so.

Table 11. The Relationship between Compliance and Natural Opportunity

		No.	Non-compliance		Compliance	
			Lower	Higher	Lower	Higher
Size	Small	47	26 (55%)	21 (45%)	0 (0%)	0 (0%)
	Medium and large	18	2 (11%)	13 (72%)	1 (2%)	2 (2%)
Market	More regulated	34	0 (0%)	32 (94%)	0 (0%)	2 (0%)
	Less regulated	32	31 (97%)	0 (0%)	1 (2%)	0 (2%)
Sector	Manufacturing	54	18 (33%)	33 (61%)	1 (2%)	2 (2%)
	Service and trade	11	10 (91%)	1 (9%)	0 (0%)	0 (0%)

Started in 2014, Master (S13) is a small manufacturer of business cards with an annual turnover of around 2.5 million RMB and 30 employees in 2016. Its net profit was about 0.5 million (20 per cent of its annual turnover). It has an online Taobao shop (a branch of the online shopping platform Alibaba). Clients access the shop through the internet; the employees design the business cards and get confirmation

from the clients, then produce the business cards and deliver them. Clients normally receive the business cards in one week. Less than ten per cent of income was shown on the tax invoices. The company reported less than 0.36 million to tax authorities every year (the evasion rate was 85.6 per cent). It is located in one of the largest migrant villages in City S. According to the owner, the area is about 500 square metres and house rent is much lower than in urban areas. The company receives payments through a private bank account instead of the corporate account. Tax officials had never bothered the company before.

Established in 2011, Zeng (S25) is a manufacturer of electronic parts, with 20 employees in a village. The company operates the business at home. It reported a turnover of 2 million RMB to tax authorities honestly in 2016. It provides its products to some larger electronic companies who always require legal tax invoices. Unlike Master, Zeng was unable to conceive its turnover due to the more regulated market niche. A total of four such manufacturers of electronic parts were interviewed in City S. In City Q, shoe companies that focused on the overseas market needed to honestly issue tax invoices so that they were allowed to export their products to other countries.

The divergent compliance levels of Master and Zeng were a result of their market environments. Size also matters. The larger the size, the higher the compliance level. Laden, for example, is a large sized shoe manufacturer of famous brand names. Tax authorities can easily obtain the company's financial information based on the

area of the premises, the number of employees, the number of bank loans, the number of franchises and the cost of machines, to name a few.

Sector also plays a role. Compared with manufacturing, service and trade are less identifiable. At the City of Shoe Street in City Q, a shoe material distribution centre, wholesalers buy and sell hundreds of shoe materials. Every afternoon, many large vehicles filled with shoe materials are stuck in the traffic jam on the street. The five shoe materials wholesalers that I interviewed—Armor (Q1), Hero (Q5), Truly (Q6), Sinda (Q7) and Smooth (Q8)—had run businesses here for many years. Their turnovers range from 5 million to 30 million. Their premises, normally covering around 540 square metres with two storeys, are full of various shoe materials. Tax authorities had no idea about their stock because they had warehouses elsewhere. Moreover, material wholesalers have no machines and normally need few employees, making it hard for tax offices to estimate sales. The material wholesalers conduct business in a more regulated market, however, which can increase compliance levels significantly.

Size, market and sector are critical factors that influence taxpayers' compliance level. Firstly, market appears to be the most important factor that forces taxpayers to comply with the tax law. Secondly, small sized companies might not show low compliance due to the force of the market, but large size companies tend to pay taxes more honestly. Finally, manufacturing might not always lead to higher compliance, but service and trade are more likely to show lower compliance. Sometimes, if they

conduct business in a more regulated market, they also become more compliant. In general, of 65 companies I interviewed, 34 were more visible and 31 were less visible to tax authorities because of their natural environment.

The Contingent Tax Preparers' Market

‘The tax system could hardly work without the help of the tax specialists, chewing the text, digesting it, turning it into small, bite-size bits, and feeding these bits to the clients.’²²⁹ Tax advisors reduce the distance between complicated tax laws and ignorant taxpayers. However, it also has been proved that tax professionals cater for clients by providing evasion advice. Hence they provide either higher or lower opportunity for taxpayers to evade. Generally, there are two types of tax advice in the market: higher compliance advice in circumstances of high transaction visibility and lower compliance advice in circumstances of low visibility. The contingent tax preparers’ market thus fails to improve the natural visibility of taxpayers.

In my sample, three companies (5 per cent) did not hire tax preparers, ten companies (15 per cent) hired full-time tax preparers and 45 companies (69 per cent) hired part-time tax preparers; the arrangements of seven companies (11 per cent) were unknown. Part-time tax preparers were pervasive in the three cities. They were responsible for keeping overt accounting books (外賬 or 陽賬), reporting tax returns, and dealing with relevant tax issues. Part-time tax preparers did not show up often in the company. They normally came to companies to collect receipts and other

²²⁹ Friedman Lawrence, *Impact: How Law Affects Behavior* (Harvard University Press 2016) 36.

documents each month or each quarter. Most companies which employed part-time tax preparers also had internal financial accountants, mostly relatives or friends of the owners, to manage covert accounting books (內賬 or 陰賬). The dual accountant mechanism was common among small and medium-sized companies.

Mr Zhu (S31), 45 years old, owned a financial bookkeeping company²³⁰ with 11 qualified tax preparers. The company helped more than 200 companies to file tax returns in City S. Every tax accountant dealt with 20 to 30 companies. Mr Zhu charged a monthly fee of 500 to 600 RMB per client, according to the complexity of the tax issues. In the second week of every month, he drove to visit about 50 companies in one week. During his visits, he collected receipts and documents, handed over books, explained new tax policies and answered taxpayers' questions. Sometimes, he just chatted with his clients and tried to maintain a long-term relationship with them. Of 30 companies that I interviewed with the assistance of Mr Zhu, half were naturally visible and half were naturally invisible. He offered them different advice.

Mr Zhu suggested an aggressive tax evasion strategy for those companies who were invisible. Found in 2014, Liti (S3) is a building decoration and design company with ten employees and an annual turnover in 2016 of 10 million RMB. The company

²³⁰ According to an official survey report, up to July 2009, a total of 129 registered bookkeeping companies were located in City S. The data were from a 2009 survey report on bookkeeping companies, conducted by the Municipal Finance Bureau. The report was available online after 21 June 2010.

is registered as a VAT small taxpayer, which requires it to pay only three per cent of its annual turnover for VAT. However, it only reported a turnover of under 5 million to local tax authorities in 2016, which means its tax evasion rate was more than 50 per cent. Mr Zhu told me:

The company only needs to issue output tax invoices in the circumstance of official or corporate projects. Its projects are mostly in individually owned luxury villas. Individuals never make a request for tax invoices. There are several loopholes in the tax system in the construction industry. The government cannot regulate.

In contrast, Mr Zhu became cautious in dealing with taxpayers who were more visible. He often told these taxpayers to operate in a legal way. Wheet (S23), established in 2013, is a manufacturer of hardware moulds with ten employees and an annual turnover in 2016 of 6.05 million RMB. It issued output tax invoices honestly in more than 90 per cent of transactions. Mr Zhu provided conservative advice in response to an enquiry from the owner.

Wheet (S23): I heard that one of my friends' companies was audited by tax authorities because of receiving illegal input tax invoices. How can we prevent the risk? We also sometimes kept such invoices. It seemed risky.

Mr Zhu (S31): You can do it, but should regularly follow up on your providers' latest situations. According to my experience, your friend must ask some risky companies to issue input tax invoices. These risky companies

are registered without using a genuine identity card. After they earn enough money, they will give up the company. Tax authorities may not be able to catch owners. As long as the one who issued you input tax invoices operated normally, you will be safe. Don't ask unknown companies to issue input tax invoices. Sometimes, it is better to pay more VAT instead of buying illegal tax invoices.

Mr Zhu's suggestions were quite ambiguous. He addressed the potential risks for the owner, but he did not ask the owner to stop keeping illegally issued input invoices. The only message he delivered was to do it carefully. The very different opinion from Liti suggested that Mr Zhu provided tax advice based on an assessment of natural visibility and institutional opportunity.

Mr Zhu had several advantages to convey accurate messages on detection possibility and sanction gravity. Firstly, he had long-term experience of tax practices which allowed him to make accurate decisions. Moreover, Mr Zhu collected all the relevant information from his clients. It was much easier for him to evaluate the overall risks of detection. Lastly, but foremost, Mr Zhu was able to access tax officials regularly in their routine activities. Not only could he obtain knowledge about new policies, but he also got enforcement messages or hints during their everyday contact. Most tax accountants, like Mr Zhu, had some connections with local officials. All these advantages only reinforced the divergence of tax advice.

There were dutious tax accountants who focused on enhancing compliance with tax laws and regulations.²³¹ The financial managers of Norkey (Q33), Shaw (Q34) and Pace (Q35) belong to this group. Ms Huang (Q36), 41 years old, was an experienced tax specialist in City Q. She had previously worked with five small and medium-sized companies. Her major focuses were regulating the corporate financial practices and making them go listed. She told me:

The last company I worked with adopted a number of tax evasion strategies. The owner hired me to regulate these problems to get his company listed. I tried my best to change the company. The most difficult thing was to change the mind of the owner...The company should not keep a covert accounting book, and it should have fully complied with the tax laws...It should also have set up a financial department and hired expensive financial experts. A lot of money needed to be spent. Only when the owner is determined can it be worked out.

Ms Huang's story showed that the dutious tax practitioners were more likely to participate in compliant preparation. They targeted a more legitimate market which was able to pay them a higher salary and follow their opinions on compliance.

The stories of Mr Zhu and Ms Huang indicate a stratification of tax preparers in China. Use of them relies on the willingness of companies. Tax preparers provide tax

²³¹ Elea Wurth, *A Will and a Way: An Analysis of Tax Practitioner Preparation Compliance* (DPhil thesis, The Australian National University 2012) 152.

advice based on companies' natural visibility as well as the levels of legal control. If taxpayers are naturally invisible and the legal control is weak, non-compliant preparation is provided; if taxpayers are naturally visible and the legal control is strong, compliant preparation is offered. The contingent tax preparers' market reinforces the divergence of natural opportunity to evade.

The Institutional Opportunity to Evade

If tax laws and tax authorities can block the opportunity to violate, there is little chance for taxpayers to evade taxes. Unfortunately, natural visibility is positively correlated with institutional opportunity to evade: that is to say, as Kagan put it, that taxpayers with low visibility are 'more costly to detect and prove than those that leave behind more easily obtained and reliable evidence'.²³² Generally, invisible taxpayers are harder to control while visible taxpayers are easier to detect. Moreover, weak institutional capacity and political constraints underline the divergence.

The Legal Design of the VAT System

The legal design of VAT tends to ignore invisible taxpayers while closely controlling visible taxpayers. There are three types of taxpayer that can be registered. Individually-owned businesses are levied a fixed amount of taxes based on the assessment of local tax offices. VAT small taxpayers are those who have a small

²³² Robert Kagan, 'On the Visibility of Income Tax Law Violations' in Roth Jefferey and John Scholz (eds), *Taxpayer Compliance Volume 2: Social Science Perspective* (University of Pennsylvania Press 1986) 79.

quantity of taxable measures and incomplete accounting records. Taxes are levied based on the amount of turnover and they are not allowed to deduct the input VAT. VAT general taxpayers who have a sound accounting system enable tax offices to ascertain the output and input VAT. They are required to keep formal input tax invoices and issue output tax invoices. Individually-owned businesses and VAT small taxpayers should register as VAT general taxpayers as soon as they reach the benchmark.

Taxpayers should firstly register with tax authorities so that their information can be traced and examined. Businesses which do not register, however, are difficult to catch due to blocked information flow and thus enforcement becomes expensive. Fashion (Q9) is one of them. When one passes their buildings, except for the clank of heavy machinery ringing in the ears, nothing is seen from outside. Fashion is by no means alone in the city. In City Q, several shoe factories or family workshops have not registered and have never paid taxes to the local offices. The owner of Lion (Q10), for example, told me that the second floor of his factory was leased to an unregistered business to produce shoes. Armor (Q2), meanwhile, registered as an individually-owned enterprise which paid only a fixed amount decided by the local tax office. Its annual turnover, however, had passed the benchmark for VAT general taxpayers, which should be levied based on its output and input taxes. The owner was unwilling to register as a VAT general taxpayer. Local tax offices had never visited the company. Even though businesses preferred to register, if their business transactions were largely conducted in cash, the tax authorities could not see them.

In contrast, the VAT system disadvantages those who honestly issue tax invoices. Local tax offices are able to evaluate the size and economic performance of businesses. As a result, they have much less chance of evading taxes.

The Legal Deterrence for Tax Deviance

The regulatory strategies also favour invisible taxpayers. Tax authorities adopt the ratio of tax burden—the rate of VAT liability to annual turnover—to monitor VAT taxpayers. Once the taxpayers fail to meet the ratio, the system will label them as risky taxpayers. This mechanism, however, only works for those who comply more with the tax laws.

Visible taxpayers might control their ratio of tax burden by keeping more input VAT invoices, resulting in an enormously fraudulent invoices market. To deter the market, tax authorities launched an annual campaign to combat fraudulent invoices. The campaign targeted those who issued or kept illegal tax invoices which were not based on genuine transactions. This strategy again was only effective with more visible taxpayers. Invisible taxpayers normally prefer not to issue output tax invoices, and they avoid keeping input tax invoices, so tax offices had no clear idea about the size of their transactions. Therefore, invisible taxpayers had less chance of being audited in the campaign. Even though they were audited, the sanctions seemed trivial because of the small scale of violations. Those who issued output tax invoices more honestly might also adopt a strategy of deducting more illegal input VAT. They

offended the tax law more regularly and the amount was also larger than for invisible taxpayers. The deterrence thus would be much higher.

Mr Zhu (S31) told me how he perceived the detection possibility and sanction severity, as well as explaining the money that taxpayers should pay if they were caught keeping illegal input tax invoices:

Q: What do you think the chances are that the company will get caught if it often keeps illegal input tax invoices—0 per cent, 25 per cent, 50 per cent, 75 per cent or 100 per cent?

Zhu: I think it is 50 per cent.

Q: If the company does get caught, what kind of legal consequences will it face?

Zhu: Normally it will be required to return VAT input tax that the company deducted before, pay corporate income tax, pay overdue fees at 0.05 per cent per day, and be fined 0.5 to 1 times the taxes that were evaded.

Q: How much of a problem would the legal consequence be for a company?

Zhu: It is a big deal for small businesses. If the company is caught keeping 1 million illegal input invoices, it should pay back 0.17 million RMB (17 per cent of 1 million) input tax to the tax authority. It should also pay arrears of corporate income tax—let us say ten per cent of 1 million, 0.1 million. The company paid eight per cent of 1 million to buy the invoices. Without

considering overdue fee and fines, the company lost 0.35 million. This is a big amount. Some small businesses cannot earn this much money per year.

With the development of technological administration, tax authorities will find the behaviour of keeping illegal input invoices more efficient and accurate than before.

Institutional Constraints in China

Institutional constraints will increase the institutional opportunity to evade. Political constraints reinforced the enforcement preference for tax offices: tax authorities had annual tax revenue targets to meet. As discussed in Chapter Two, tax authorities and local government focused on meeting the tax revenue targets. When they failed to fulfil the target, they would go for some medium and larger companies. The owner of King (Q14) told me that:

Recently, they [the local tax officials] came up with a new idea. They hinted to the head of the Shoe Business Association²³³ that they would like the business to conduct a self-check and behave more compliantly, otherwise they would inspect the businesses. Then the head would assign the amount of taxes to the members of the association [...] Most members were medium or large-sized companies.

²³³ The Shoe Business Association was a private organization that accumulated the local shoe businesses. It would help the businesses to deal with business disputes with businesses from other areas, representing its members to negotiate with the government,

The financial manager of Fortune (Q24) also said:

If the tax authority cannot implement the tax revenue target, it will require some larger companies to deduct less input VAT or pay corporate income tax in advance.²³⁴ Sometimes they also ask us simply to pay more taxes.

They ask: we do not have a choice. We should cooperate with them. If you cooperate with them, they will also cooperate with you; if you make trouble for them, they will also make trouble for you. So actually the government is ruling businesses. We cannot violate them; otherwise, they will audit your company. No company is completely compliant with the tax law. If you get caught, you still need to pay. The consequence is the same as to pay voluntarily what they have told you before.

The two messages reveal that medium and larger companies that pay taxes honestly were more likely to be audited and interest extracted by the local tax authorities. They thus face more economic pressures than small businesses. Their institutional opportunity to evade is often lower than that of small or invisible businesses.

Local business taxpayers maintain good relations with the local tax officials so that they can remain free from detection and sanctions. Normally, the more social the

²³⁴ I mentioned the similar strategy that how tax officials tried to fulfill the tax targets in the Chapter Two.

community, the more likely it is that the local tax officials and local businesses collude.

The case of Hero (Q5) in City Q showed the significant impact of *guanxi* on deterrence. Hero, founded in 1997, is a material wholesaler in the distribution centre. It registered as an individually-owned enterprise, and was required to pay fixed VAT of 0.08 million RMB per year. Tax authorities had estimated that its annual turnover since 2008 was around 2.8 million: its actual annual turnover, however, had increased to 30 million since 2013, reaching the threshold of VAT general taxpayers. Tax offices had come twice and for three years required Hero to change the type of taxpayer. After the owner employed his social connections, the company did not need to register as a VAT general taxpayer. Several companies also confessed to me that they find *guanxi* to reduce the sanctions (Q2, Q3, Q7, S8 and S23). The existing regulations and discipline mechanism has been shown to be ineffective on agents in China.²³⁵

Conclusions

The experience of south-eastern China reveals two distinct levels of structural opportunity to evade. The divergence in structural opportunity results from interactions between the social and institutional opportunities to evade. Taxpayers who enjoyed high structural opportunity to evade had two strokes of luck to thank.

²³⁵ See Yongshun Cai and Lin Zhu, 'Disciplining Local Officials in China: The Case of Conflict Management' (2013) 70 *The China Journal* 98, 119.

Firstly, there was natural invisibility due to small size, less regulated market, sector and the like. The second lucky break came when tax laws and tax authorities failed to block their opportunity to evade.

Taxpayers who had low structural opportunity to evade suffered a double blow. One aspect was their natural visibility, resulting from the larger size, more regulated market, or sector: this forced taxpayers to issue output tax invoices honestly, which means they exposed their authentic annual income to tax authorities. However, taxpayers perceived low risk of being caught if they failed to issue tax invoices. The other aspect derived from the strict institutional control. The ratio of tax burden and annual campaign of fraudulent invoices worked effectively on more visible taxpayers. The political preferences and special institutional environment encouraged tax authorities to focus more on more visible companies, which enhanced the situation.

According to Kagan, the violations of naturally invisible taxpayers are ‘more costly to detect and prove’.²³⁶ Hence, even in western developed countries where the institutional capacity to detect violations is stronger, the institutional opportunity of invisible taxpayers remains high. Due to the particular institutional environment of tax authorities in China, they responded more to the higher level tax office instead of the public; however, this will make the institutional opportunity for invisible taxpayers to evade much higher than where tax authorities are not influenced by such

²³⁶ Robert Kagan, ‘On the Visibility of Income Tax Law Violations’ in Roth Jefferey and John Scholz (eds), *Taxpayer Compliance Volume2: Social Science Perspective* (University of Pennsylvania Press 1986) 79.

circumstances. If the social opportunity to evade is high, the overall opportunity to evade will be higher. More effective legal controls can achieve a higher compliance level. When the social opportunity to evade is low, the overall opportunity to evade will be lower. If the tax authorities and the state provide less institutional opportunity to evade, the overall opportunity to evade will be lower than for those who have higher institutional opportunity to evade.

This chapter provides several structural characteristics of taxpayers that might influence the opportunity to evade. The findings imply that social opportunity has a critical impact on tax compliance. Even in developed countries, high social visibility leads to lower tax compliance.²³⁷ The effectiveness of the legal controls, however, can increase tax compliance. It shows that developing countries with a worse institutional environment will have more opportunities for taxpayers to evade than developed countries. Not only should the state improve the techniques and enforcement for invisible taxpayers, but it should also discipline tax agents and enhance their accountability to the public instead of the higher-level tax offices.

²³⁷ See Robert Kagan, 'On the Visibility of Income Tax Law Violations' in Roth Jefferey and John Scholz (eds), *Taxpayer Compliance Volume2: Social Science Perspective* (University of Pennsylvania Press 1986); Caroline Adams and Paul Webley, 'Small Business Owners' Attitudes on VAT Compliance in the UK' (2001)22 *Journal of Economic Psychology* 195, 216; Bernadette Kamleitner, Christina Korunka and Erich Kirchler, 'Tax Compliance of Small Business Owners: A Review' (2012) 18 *International Journal of Entrepreneurial Behaviour & Research* 330, 351.

Chapter Four. Do Procedural Norms Matter in the Current Chinese Tax Context?

Many studies have proved that social norms could be a long-term and enduring strategy compared to deterrence to shape corporate compliance decisions within the fields of, for example, policing, and tax and environment regulation.²³⁸ In this study, I group social norms into substantive norms and procedural norms. Substantive norms refer to widespread perceptions of ‘the fairness of the outcomes of a resource allocation or distribution’.²³⁹ Procedural norms are linked to interactions between the enforcing authority and the regulated.²⁴⁰

In his ground-breaking work, Tyler asserted that ‘legitimacy has a significant independent effect on compliance, even when other potential causal factors are

²³⁸ See Harold Grasmick and Donald Green, ‘Legal Punishment, Social Disapproval and Internalization as Inhibitors of illegal Behavior’ (1980) 71 *The Journal of Criminal Law & Criminology* 325, 335; Eric Posner, ‘Law and Social Norms: The Case of Tax Compliance’ (2000) 86 *Virginia Law Review* 1781, 1819; Michael Vandenbergh, ‘Beyond Elegance: A Testable Typology of Social Norms in Corporate Environmental Compliance’ (2003) 22 *Stanford Environmental Law Journal* 55, 144; Neil Gunningham, Robert Kagan and Dorothy Thornton, *Shades of Green: Business, Regulation, and Environment* (Stanford University Press 2003); Neil Gunningham, Robert Kagan and Dorothy Thornton, ‘Social License and Environmental Protection: Why Businesses Go Beyond Compliance’ (2004) 29 *Law and Society Inquiry* 307, 341.

²³⁹ Michael Wenzel, ‘Tax Compliance and Psychology of Justice: Mapping the Field’ in Valerie Braithwaite (ed), *Taxing Democracy* (Ashgate Publishing 2002) 45.

²⁴⁰ Michael Vandenbergh, ‘Beyond Elegance: A Testable Typology of Social Norms in Corporate Environmental Compliance’ (2003) 22 *Stanford Environmental Law Journal* 55, 144.

controlled for.²⁴¹ He then suggested that procedural fairness, which includes quality of decision-making and of personal treatment, increases the legitimacy of an authority and the obligation to obey the law.²⁴² Moreover, ‘fair procedures are a cushion of support against the potentially damaging effects of unfavourable outcomes.’²⁴³ Tyler and his colleagues further found that procedural justice can have both an indirect effect on cooperation through its effect on legitimacy and a direct effect which is independent of legitimacy.²⁴⁴ In general, procedural justice is central in shaping people’s attitudes and behaviours related to cooperation and compliance.

In a departure from Tyler’s original work, researchers have thrown doubt on the effects of procedural justice.²⁴⁵ Murphy et al. distinguished between authority and

²⁴¹ Tom Tyler, *Why People Obey the Law* (Yale University Press 1990) 58.

²⁴² *ibid*; Tom Tyler, ‘Procedural Fairness and Compliance with the Law’ (1997) 133 *Swiss Journal of Economics and Statistics* 219, 240.

²⁴³ Tom Tyler, *Why People Obey the Law* (Yale University Press 1990) 101.

²⁴⁴ Tom Tyler, ‘Procedural Justice, Legitimacy, and the Effective Rule of Law’ (2003) 30 *Crime and Justice* 283, 357; Tom Tyler, Stephen Schulhofer and Aziz Z. Huq, ‘Legitimacy and Deterrence Effects in Counterterrorism Policing: A Study of Muslim Americans’ (2010) *Law & Society Review* 365, 401; Aziz Z. Huq, Tom Tyler and Stephen Schulhofer, ‘Why Does the Public Cooperate with Law Enforcement? The Influence of the Purpose and Targets of Policing’ (2011) 17 *Psychology, Public Policy, and Law* 419, 450.

²⁴⁵ See Kristina Murphy, Tom Tyler and Amy Curtis, ‘Nurturing Regulatory Compliance: Is Procedural Justice Effective When People Question the Legitimacy of the Law?’ (2009) 3 *Regulation & Governance* 1, 26; Kristina Murphy and Adrian Cherney, ‘Fostering Cooperation with the Police: How Do Ethnic Minorities in Australia Respond to Procedural Justice-Based Policing?’ (2011) 44 *Australian & New Zealand Journal of Criminology* 235, 257; Kristina Murphy and Adrian Cherney, ‘Understanding Cooperation with Police in a Diverse Society’ (2012) 52 *British Journal of Criminology* 181, 201.

legal legitimacy, which involves ‘a consideration of the relationship of those rules and laws to a person’s moral or ethical values.’²⁴⁶ The study found that legal legitimacy moderates the effect of procedural fairness on compliance. Studies have also suggested that procedural justice is effective for reducing resistant defiance instead of dismissive defiance.²⁴⁷ Nagin and Telep argued that existing studies reflect little causal connection between procedural fairness and legitimacy and compliance.²⁴⁸ Based on direct tests, some researchers found an asymmetrical impact of procedural fairness²⁴⁹—that is, ‘police disrespect significantly decreased the odds of compliance, but police making a special effort to show respect did not significantly affect

²⁴⁶ Kristina Murphy, Tom Tyler and Amy Curtis, ‘Nurturing Regulatory Compliance: Is Procedural Justice Effective When People Question the Legitimacy of the Law?’ (2009) 3 *Regulation & Governance* 3.

²⁴⁷ Justice Tankebe, ‘Public Cooperation with the Police in Ghana: Does Procedural Fairness Matter?’ (2009) 47 *Criminology* 701, 730; Kristina Murphy and Adrian Cherney, ‘Fostering Cooperation with the Police: How Do Ethnic Minorities in Australia Respond to Procedural Justice-Based Policing?’ (2011) 44 *Australian & New Zealand Journal of Criminology* 235, 257; Kristina Murphy and Adrian Cherney, ‘Understanding Cooperation with Police in a Diverse Society’ (2012) 52 *British Journal of Criminology* 181, 201; Kristina Murphy, ‘Turning Defiance into Compliance with Procedural Justice: Understanding Reactions to Regulatory Encounters through Motivational Posturing’ (2016) 10 *Regulation & Governance* 93, 109.

²⁴⁸ Daniel Nagin and Cody Telep, ‘Procedural Justice and Legal Compliance’ (2017) 13 *Annual Review of Law and Social Science* 1, 24.

²⁴⁹ Stephen Mastrofski, Jefferey Snipes and Anne Supina, ‘Compliance on Demand: The Public’s Response to Specific Police Requests’ (1996) 33 *Journal of Research in Crime and Delinquency* 269, 305; Yudu Li, Ren Ling and Luo Fei, ‘Is Bad Stronger than Good? The Impact of Police-Citizen Encounters on Public Satisfaction with Police’ (2016) 39 *Policing: An International Journal of Police Strategies & Management* 109, 126.

compliance.²⁵⁰ Contrary to the predominant findings, Tankebe found that distributive fairness also demonstrates a statistically significant influence on cooperation.²⁵¹ He said:

[W]e need to be careful when equating procedural fairness with legitimacy, because other factors, such as outcome favourability and distributive fairness, are sometimes important in certain circumstances.²⁵²

Do procedural norms really matter in a context where rule of law is still developing? Decades of research suggest that people favour procedural norms over substantive norms, and that these patterns are universal.²⁵³ These researches, however, are mostly conducted in liberal and developed states. A few exceptions are conducted

²⁵⁰ Daniel Nagin and Cody Telep, 'Procedural Justice and Legal Compliance' (2017) 13 Annual Review of Law and Social Science 9.

²⁵¹ Justice Tankebe, 'Public Cooperation with the Police in Ghana: Does Procedural Fairness Matter?' (2009) 47 Criminology 1265, 1293.

²⁵² *ibid* 1270.

²⁵³ Ethan Michelson and Benjamin Read, 'Public Attitudes toward Official Justice in Beijing and Rural China' in Margaret Woo and Mary Gallagher (eds), *Chinese Justice: Civil Dispute Resolution in Contemporary China* (Cambridge University Press 2011) 169, 203.

in Ghana,²⁵⁴ China²⁵⁵ and the Caribbean.²⁵⁶ Surveying public attitudes towards official justice in Beijing, China, Michelson and Read, for example, found that respondents conflated procedural justice and distributive justice. They suggest that negative personal experience with official justice leads to far less confidence in courts and the police. Yan et al. found no causal link between procedural justice and compliance decisions with pesticide regulation among farmers in Hunan Province, in the middle of China.²⁵⁷ To what extent are these findings in China true? Without evidence from developing countries and various contexts, it is hard for the theory to become a universal notion. In a recent review on procedural justice, Murphy asserted:

²⁵⁴ Justice Tankebe, 'Public Cooperation with the Police in Ghana: Does Procedural Fairness Matter?' (2009) 47 *Criminology* 1265, 1293.

²⁵⁵ Ethan Michelson and Benjamin Read, 'Public Attitudes toward Official Justice in Beijing and Rural China' in Margaret Woo and Mary Gallagher (eds), *Chinese Justice: Civil Dispute Resolution in Contemporary China* (Cambridge University Press 2011) 169, 203; Huiqi Yan, Jeroen Van der Heijden and Benjamin Van Rooij, 'Symmetric and Asymmetric Motivations for Compliance and Violation: A Crisp Set Qualitative Comparative Analysis of Chinese Farmers' (2017) 11 *Regulation & Governance* 64, 80.

²⁵⁶ Devon Johnson, Edward Maguire and Joseph Kuhns, 'Public Perceptions of the Legitimacy of the Law and Legal Authorities: Evidence from the Caribbean' (2014) 48 *Law & Society Review* 947, 978.

²⁵⁷ Huiqi Yan, Jeroen Van der Heijden and Benjamin Van Rooij, 'Symmetric and Asymmetric Motivations for Compliance and Violation: A Crisp Set Qualitative Comparative Analysis of Chinese Farmers' (2017) 11 *Regulation & Governance* 64, 80.

What is needed for the future of procedural justice scholarship is research [...] that seeks to better understand the contexts where procedural justice works more or less effectively or why it works as it does.²⁵⁸

This chapter enters this debate by examining the role of procedural and substantive norms in businesses' decision-making on tax payment. Based on in-depth anthropological investigations of 65 private businesses in two south-eastern cities in China, I suggest that procedural norms play a negligible role in nurturing tax compliance. Instead, substantive norms are essential for taxpayers to obey or disobey the tax law. These findings compel us to reconsider the boundaries of the theory of procedural norms. They also enrich the knowledge about how to improve legitimacy and compliance in developing countries.

The Dimensions of Social Norms in the Tax Context

Social norms and their component elements can be framed differently based on the particular regulatory contexts, but generally can be grouped into procedural and substantive norms.²⁵⁹ Procedural norms draw on perceived trust and the quality of treatment and decision-making.²⁶⁰ It is believed that if the regulated individuals or

²⁵⁸ Kristina Murphy, 'Procedural Justice and Its Role in Promoting Voluntary Compliance' in Peter Drahos (ed), *Regulatory Theory: Foundations and Applications* (Australian National University Press 2017) 52.

²⁵⁹ Michael Vandenbergh, 'Beyond Elegance: A Testable Typology of Social Norms in Corporate Environmental Compliance' (2003) 22 *Stanford Environmental Law Journal* 55,144.

²⁶⁰ Tom Tyler, 'Procedural Justice, Legitimacy, and the Effective Rule of Law' (2003) 30 *Crime and Justice* 283, 357; Jason Sunshine and Tom Tyler, 'The Role of Procedural Justice and Legitimacy in

companies perceive fairness of treatment and decision-making, they are more willing to comply with the law and regulations. Furthermore, when the regulated party trusts the enforcing agency, the outcome of enforcement will be better,²⁶¹ which is in line with ‘the norm of reciprocity’.²⁶²

In contrast, substantive norms centre on the moral assessment of the outcomes of resource allocation or distribution. Even though substantive norms have been traditionally conceptualized as instrumental considerations, more recently, Wenzel has viewed them as a process of self-categorization,²⁶³ defined as a state where people get what they deserve or what they are entitled to.²⁶⁴ It is a long-lasting and widespread perception or norm that addresses outcome fairness in a social

Shaping Public Support for Policing’ (2003) 37 *Law & Society Review* 513, 548; Devon Johnson, Edward Maguire and Joseph Kuhns, ‘Public Perceptions of the Legitimacy of the Law and Legal Authorities: Evidence from the Caribbean’ (2014) 48 *Law & Society Review* 967.

Johnson et al. (2014) find ‘trust and procedural justice may be one and the same in the minds of citizens’.

²⁶¹ Tom Tyler and Yuen Huo, *Trust in the Law: Encouraging Cooperation with the Police and Courts* (Russell Sage Foundation 2005).

²⁶² Michael Vandenberg, ‘Beyond Elegance: A Testable Typology of Social Norms in Corporate Environmental Compliance’ (2003) 22 *Stanford Environmental Law Journal* 55, 144.

²⁶³ Michael Wenzel, ‘The Impact of Outcome Orientation and Justice Concerns on Tax Compliance: The Role of Taxpayers’ Identity’ (2002) 87 *Journal of Applied Psychology* 629, 645; Wenzel Michael ‘A Social Categorization Approach to Distributive Justice’ (2004) 15 *European Review of Social Psychology* 219, 257.

²⁶⁴ Michael Wenzel, ‘A Social Categorization Approach to Distributive Justice: Social Identity as the Link between Relevance of inputs and Need for Justice’ (2001) 40 *British Journal of Social Psychology* 315, 335.

community. The norm is the reflection of the existing rules, laws or regulations that an authority enforces. Hence, substantive norms are not dissimilar to ‘moral support of law’s content’,²⁶⁵ ‘the right to make a living’,²⁶⁶ ‘social licence’,²⁶⁷ ‘unreasonableness’,²⁶⁸ ‘legal cynicism’²⁶⁹ or ‘the legitimacy of law’, which means ‘moral values’ regarding tax evasion (Table 12).²⁷⁰

²⁶⁵ Stig Gezelius and Maria Hauck, ‘Toward a Theory of Compliance in State, Regulated Livelihoods: A Comparative Study of Compliance Motivations in Developed and Developing World Fisheries’ (2011) 45 *Law & Society Review* 435, 470.

²⁶⁶ Stig Gezelius, ‘Three Paths from Law Enforcement to Compliance: Cases from the Fisheries’ (2007) 66 *Human Organization* 414, 425.

²⁶⁷ Neil Gunningham, Robert Kagan and Dorothy Thornton, ‘Social License and Environmental Protection: Why Businesses Go Beyond Compliance’ (2004) 29 *Law and Society Inquiry* 307, 341.

²⁶⁸ Robert Kagan and John Scholz, ‘The “Criminology of the Corporation” and Regulatory Enforcement Strategies’ in Keith Hawkins and John Thomas (eds), *Enforcing Regulation* (Kluwer-Nijhoff Publishing 1984) 67.

²⁶⁹ See Jeffrey Fagan and Tom Tyler, ‘Legal Socialization of Children and Adolescents’ (2005) 18 *Social Justice Research* 217, 242; Devon Johnson, Edward Maguire and Joseph Kuhns, ‘Public Perceptions of the Legitimacy of the Law and Legal Authorities: Evidence from the Caribbean’ (2014) 48 *Law & Society Review* 947, 978.

²⁷⁰ Kristina Murphy, Tom Tyler and Amy Curtis, ‘Nurturing Regulatory Compliance: Is Procedural Justice Effective When People Question the Legitimacy of the Law?’ (2009) 3 *Regulation & Governance* 1, 26.

Table 12. Two-Factor Social Norms and Some Leading Literature

Two-Factor Social Norms	Related Dimensions	Context	Some Leading Literature
Procedural norms	Procedural fairness and trust	Police	e.g. Tyler 1990; Sunshine and Tyler 2003; Johnson et al. 2014
	Government as insider (fair procedures)	Tax	Posner 2000
	Procedural norms	General	Vandenbergh 2003
	Treatment of taxpayers	Tax	Feld and Frey 2007
	Reciprocity and responsive service	Tax	Smith 1990
Substantive norms	Social disapproval; moral commitment	General	Grasmick and Green 1980
	Government as outsider; government as insider (tax equity)	Tax	Posner 2000
	Distributive fairness	Police	Tankebe 2013
	Social licence	Environment	Gunningham et al. 2003, 2004; Kagan et al. 2010; Thornton et al. 2009
	Moral support of law's content	Fishery	Gezelius and Hauck 2011
	Legal legitimacy or legitimacy of law	Tax, social security, policing, etc.	Murphy et al. 2009; Murphy and Cherney 2012; Cherney and Murphy 2013
	Unreasonableness		Kagan and Scholz 1984
	Distributive norm	General	Vandenbergh 2003
	Commitment	Tax	Braithwaite 2002
	Social exchange between citizens and government	Tax	Feld and Frey 2007
Distributive justice	Tax	Wenzel 2001,2002	

Tax compliance researchers view social norms as a critical factor. In a classic study, Scholz and Pinney examined how duty and fear affect tax compliance.²⁷¹ Duty, as they define, is the desire to conform to internalized norms or beliefs about right and wrong. Braithwaite suggests that commitment, which ‘reflects beliefs about the desirability of tax systems and feelings of moral obligation to act in the interest of the

²⁷¹ John Scholz and Neil Pinney ‘Duty, Fear, and Tax Compliance: The Heuristic Basis of Citizenship Behavior’ (1995) 39 American Journal of Political Science 490, 512.

collective and pay one's tax with good will',²⁷² is essential to promote tax compliance. Duty or commitment are the same as the concept of obligation to obey the law in legitimacy studies.

The normative factors that contribute to tax compliance fit well in my two-factor social norm. For example, researchers find the horizontal norm—meaning an individual's tax burden—if about the same as that of comparable others, increases tax compliance²⁷³ and weak vertical norm increases tax evasion.²⁷⁴ Taxpayers also evaluate their own tax rates or tax burden relative to their income levels.²⁷⁵ In all, the horizontal, vertical and personal norms can affect tax compliance. Furthermore, if taxpayers see the way that a government spends money as unjust, compliance becomes less assured.²⁷⁶ This is effectively about a trade-off between taxpayers and

²⁷² Valerie Braithwaite, 'Dancing with Tax Authorities: Motivational Postures and Non-compliant Compliant Actions' in Valerie Braithwaite (ed), *Taxing Democracy* (Ashgate Publishing 2002) 18.

²⁷³ Tom Spicer and Lee Becker, 'Fiscal Inequity and Tax Evasion: An Experimental Approach' (1980) 33 *National Tax Journal* 171, 175; Karyl Kinsey and Howard Grasmick, 'Did the Tax Reform Act of 1986 Improve Compliance? Three Studies of Pre- and Post- TRA Compliance Attitudes' (1993) 15 *Law & Policy* 239, 325; Ana De Juan, Miguel Lasheras and Rafaela Mayo, 'Voluntary Tax Compliant Behavior of Spanish Income Tax Payers' (1994) 49 *Public Finance [Finances Publiques]* 90, 105.

²⁷⁴ Michael Roberts and Hite Peggy, 'Progressive Taxation, Fairness, and Compliance' (1994) 16 *Law & Policy* 27, 48.

²⁷⁵ Michael Wenzel, 'Tax Compliance and Psychology of Justice: Mapping the Field' in Valerie Braithwaite (ed), *Taxing Democracy* (Ashgate Publishing 2002) 41, 70.

²⁷⁶ Alm James, McClelland Gary and Schulze William, 'Why Do People Pay Taxes?' (1992) 48 *Journal of Public Economics* 21, 48; Alm James, Jackson Betty and McKee Michael, 'Fiscal Exchange, Collective Decision Institutions and Tax Compliance' (1993) 22 *Journal of Economic Behavior and Organization* 285, 303; Lars Feld and Bruno Frey, 'Tax Compliance as the Result of a Psychological

the government. Material and non-material benefits are both included. These issues have been studied under the label ‘exchange equity’.²⁷⁷ Horizontal, vertical, personal and exchange norms can be viewed as the components of substantive norms.

The other strand of studies focuses on procedural norms. Smith and Stalans and Smith regard respectful treatment as a positive incentive that can create a norm of reciprocity.²⁷⁸ It boosts long-lasting compliance more than materialistic incentives. After interviewing taxpayers and their representatives who have encountered tax auditors before, Stalans and Lind find that respondents who mention respectful treatment rate auditors as procedurally fairer.²⁷⁹ Not only do respectful treatment and responsive service matter, but so too do a perceived fairer decision-making process and trust.²⁸⁰

Tax Contract: The Role of Incentives and Responsive Regulation’ (2007) 29 *Law & Policy* 102, 120.

²⁷⁷ Michael Wenzel, ‘Tax Compliance and Psychology of Justice: Mapping the Field’ in Valerie Braithwaite (ed), *Taxing Democracy* (Ashgate Publishing 2002) 41, 70.

²⁷⁸ Kent Smith and Loretta Stalans, ‘Encouraging Tax Compliance with Positive Incentives: A Conceptual Framework and Research Directions’ (1991) 13 *Law & Policy* 35, 53; Kent Smith, ‘Reciprocity and Fairness: Positive Incentives for Tax Compliance’ in Joel Slemrod (ed), *Why People Pay Taxes: Tax Compliance and Enforcement* (University of Michigan Press 1992) 223, 250.

²⁷⁹ Loretta Stalans and Allan Lind, ‘The Meaning of Procedural Fairness: A Comparison of Taxpayers’ and Representatives’ Views of Their Tax Audits’ (1997) 10 *Social Justice Research* 311, 331.

²⁸⁰ See Kristina Murphy, ‘Regulating More Effectively: The Relationship between Procedural Justice, Legitimacy, and Tax Non-Compliance’ (2005) 32 *Journal of Law and Society* 562, 589; Erich Kirchler, Erik Hoelzl and Ingrid Wahl, ‘Enforced versus Voluntary Tax Compliance: The “Slippery Slope” Framework’ (2008) 29 *Journal of Economic Psychology* 210, 225.

Descriptions of the Variables

Following prior studies,²⁸¹ I explored procedural norms with seven dimensions including dignity (did tax officials treat you with respect and dignity?), trustworthiness (did tax officials try to be fair?), process control (did tax officials give you a chance to express your views?), equal treatment (did tax officials treat every

²⁸¹ Valerie Braithwaite, 'The Community Hopes, Fears and Actions Survey: Goals and Measures' The Australian National University Working Paper 3/2001 <<https://openresearch-repository.anu.edu.au/bitstream/1885/41622/2/WP4.pdf>> accessed 3 December 2016; Jason Sunshine and Tom Tyler, 'The Role of Procedural Justice and Legitimacy in Shaping Public Support for Policing' (2003) 37 *Law & Society Review* 513, 548; Kristina Murphy, 'Regulating More Effectively: The Relationship between Procedural Justice, Legitimacy, and Tax Non-Compliance' (2005) 32 *Journal of Law and Society* 562, 589; Tom Tyler, 'Procedural Justice and the Courts' (2007) 44 *Court Review: The Journal of the American Judges Association* 26, 31; Kristina Murphy, Tom Tyler and Amy Curtis, 'Nurturing Regulatory Compliance: Is Procedural Justice Effective When People Question the Legitimacy of the Law?' (2009) 3 *Regulation & Governance* 1, 26; Tom Tyler, Stephen Schulhofer and Aziz Z. Huq, 'Legitimacy and Deterrence Effects in Counterterrorism Policing: A Study of Muslim Americans' (2010) 44 *Law & Society Review* 365, 401; Aziz Z. Huq, Tom Tyler and Stephen Schulhofer, 'Why Does the Public Cooperate with Law Enforcement? The Influence of the Purpose and Targets of Policing' (2011) 17 *Psychology, Public Policy, and Law* 419, 450; Kristina Murphy and Adrian Cherney, 'Fostering Cooperation with the Police: How Do Ethnic Minorities in Australia Respond to Procedural Justice-Based Policing?' (2011) 44 *Australian & New Zealand Journal of Criminology* 235, 257; Kristina Murphy and Adrian Cherney, 'Understanding Cooperation with Police in a Diverse Society' (2012) 52 *British Journal of Criminology* 181, 201; Adrian Cherney and Kristina Murphy, 'Policing Terrorism with Procedural Justice: The Role of Police Legitimacy and Law Legitimacy' (2013) 46 *Australian & New Zealand Journal of Criminology* 403, 421; Justice Tankebe, 'Viewing Things Differently: The Dimensions of Public Perceptions of Police Legitimacy' (2013) 51 *Criminology* 103, 135; Kristina Murphy, 'Turning Defiance into Compliance with Procedural Justice: Understanding Reactions to Regulatory Encounters through Motivational Posturing' (2016) 10 *Regulation & Governance* 93, 109 .

taxpayer equally?), neutrality (did tax officials make decisions based on facts instead of their own opinions?), lawfulness (did tax officials abide by the law?) and responsiveness (did tax officials respond to your needs and concerns?) Lawfulness and responsiveness were adopted from Tankebe's four-factor legitimacy.²⁸²

Substantive norms were measured by four aspects: individual, horizontal, vertical and exchange equity. Individual norms were measured by asking whether respondents felt that they paid too much in relation to their income; horizontal norms how they felt about the difference between the amount of tax paid by themselves and others who were in the same boat; vertical norms were measured by asking how they felt about the difference between the amount of tax they paid and that paid by larger and smaller companies; exchange norms centre on comparisons of social benefits and taxes.

Procedural Norms Fail to Contribute Independently to Tax

Compliance

An overview of the perception of procedural norms in the two cities is presented here (Table 13). Of 65 businesses, 54 filled in questionnaires (response rate: 83 per cent). The following analysis will mainly focus on these 54 companies. Table 13 demonstrates that 58 per cent of respondents (14 out of 24) perceived negative procedural norms in City Q, while 87 per cent of respondents (26 out of 30) perceived positive procedural norms in City S. The table also lists the perceptions on seven

²⁸² Justice Tankebe, 'Viewing Things Differently: The Dimensions of Public Perceptions of Police Legitimacy' (2013) 51 *Criminology* 103, 135.

dimensions of procedural norms in the two cities. The percentages of respondents who had positive perceptions in terms of dignity, process control and responsiveness were 63 per cent, 60 per cent and 50 per cent in City S, compared with 17 per cent, 4 per cent and 17 per cent in City Q. Though respondents in City S had fewer positive feelings on the rest, the average percentages remained much higher than in City Q. In City Q, respondents perceived negatively in most dimensions except for neutrality, with the same percentage for each attitude. Generally, interviewees in City S tended to view the procedures that tax officials used as fair.

Table 13. Procedural Norms among Non-Compliant Taxpayers in the Two Cities

Dimensions of procedural fairness	City Q				City S			
	Unfair	Neutral	Fair	Don't Know	Unfair	Neutral	Fair	Don't Know
Dignity <i>Did tax officials treat you with respect and dignity?</i>	15(63%)	5(21%)	4(17%)	0(0%)	0(0%)	8(27%)	19(63%)	3(10%)
Trustworthiness <i>Did tax officials try to be fairly?</i>	13(54%)	7(29%)	3(13%)	1(4%)	2(7%)	10(33%)	13(43%)	5(17%)
Process control <i>Did tax officials give you chance to express your views?</i>	14(58%)	9(38%)	1(4%)	0(0%)	0(0%)	6(20%)	18(60%)	6(20%)
Equal treatment <i>Did tax officials treat every taxpayer equally?</i>	17(71%)	5(21%)	2(8%)	0(0%)	4(13%)	9(30%)	12(40%)	5(17%)
Neutrality <i>Did tax officials make decisions on facts instead of their own opinions?</i>	6(25%)	5(21%)	7(29%)	6(25%)	1(3%)	11(37%)	13(43%)	5(17%)
Lawfulness <i>Did tax officials abide the law?</i>	10(42%)	9(38%)	2(8%)	3(13%)	1(3%)	10(33%)	14(47%)	5(17%)
Responsiveness <i>Did tax officials respond to your needs and concerns?</i>	17(71%)	3(13%)	4(17%)	0(0%)	3(10%)	10(33%)	15(50%)	2(7%)
In total	14(58%)	2(8%)	8(33%)		1(3%)	3(10%)	26(87%)	

Note: Percentages do not always add up to 100 because of rounding.

My sample included 20 taxpayers (37 per cent) who had one or more experiences of tax enforcement—for instance, audit and sanction—and 34 taxpayers (63 per cent) who had never had an enforcement experience with tax authorities.

Low Significance of Positive Procedural Norms in Tax Compliance

Table 14 points out the interaction between procedural norms and tax compliance in general without considering other factors. In City Q, of eight interviewees who indicated positive procedural norms, 75 per cent stated non-compliance and 25 per cent stated compliance. In City S, among 26 taxpayers who perceived positive procedural norms, all were non-compliant: 54 per cent (14 out of 26) had lower compliance and 46 per cent (12 out of 30) had higher compliance. In total, of 34 respondents who had positive procedural norms, 94 per cent (32 out of 34) stated non-compliance and only six per cent (2 out of 34) stated compliance. The statistical results suggest that the impact of procedural norms on compliance was trivial in my sample.

Table 14. Procedural Norms and Tax Compliance in the Two Cities

	Non-compliance		Compliance		Total
	Lower	Higher	Lower	Higher	
<i>City Q</i>					
Fair	2(25%)	4(50%)	0(0%)	2(25%)	8
Neutral	0(0%)	2(100%)	0(0%)	0(0%)	2
Unfair	9(64%)	4(29%)	1(7%)	0(0%)	14
Total	11(46%)	10(42%)	1(4%)	2(8%)	24 (100%)
<i>City S</i>					
Fair	14(54%)	12(46%)	0(0%)	0(0%)	26
Neutral	1(33%)	2(67%)	0(0%)	0(0%)	3
Unfair	0(0%)	1(100%)	0(0%)	0(0%)	1
Total	15(50%)	15(50%)	0(0%)	0(0%)	30 (100%)

During our conversations, respondents also provided a clearer message that they were not concerned about procedural norms when they made decisions on compliance or evasion during our open conversations. In 2013, Yao (S19) was a manufacturer of hardware moulds that shaped steel materials, with eight workers and a turnover of 1.52 million RMB reported to the local tax authority in 2016. It reported 76 per cent of its genuine turnover. The dialogue presented below shows the role of procedural norms in the owner's decision-making on tax compliance.

Q: Overall, how do you evaluate the procedure that the local tax authority used for collecting taxes and enforcing the law?

Yao: To be honest, the tax authority in City S is much better than in other places. They are regulated. They do not collect more than the amount that the law requires. [...] After they moved to the Tax Service Hall (纳税服务大厅), their services were good, and they were very polite.

...

Q: Do you report your annual turnover honestly?

Yao: We have to. More than 90 per cent of my clients demanded tax invoices. If I do not issue them, they will not do business with me. But this is so painful. Basically, I am working for CPC, only make a living (我基本是在給共產黨打工，就賺了個吃的).

Q: Do you use some ways to reduce the taxes?

Yao: Try to get some input invoices to reduce some of the taxes. Otherwise, I told you, it is so hard.

Q: But you just say procedure is fair: can't it make you pay taxes more honestly?

Yao: This has nothing to do with it. The price of steel increased this year [*deep sigh*].

In his reply 'This has nothing to do with it', 'this' means compliance and 'it' refers to fair procedure. The owner subsequently complained about the rising steel price. During our 65 minute conversation, the owner kept complaining about the high tax burden, the harsh market environment and the unreasonableness of VAT. Output tax invoices were issued honestly just because his clients asked him to do it. He tried hard to lower his taxes to make a living in the market.

Wood (S14), located in City S and established in 2012, is a speciality paper wholesaler. It reported a turnover of 3 million RMB in 2015 and paid 0.03 million, while its actual turnover was 5.8 million. The company also evaded by keeping genuine input invoices or illegally obtaining input tax invoices. Though the owner evaluated the procedure by which tax authorities collect taxes and enforce the tax law quite positively, the company was involved in aggressive cheating. Wood's compliance level is much lower than Yao's compliance level. The major reason is that Yao's structural opportunity to evade is much lower than Wood's. Though Wood, like Yao, evaluated the local tax authorities positively, its compliance level is much lower.

The positive procedural norm appeared to be ignored when taxpayers were making decisions.

Both statistical results and in-depth interviews demonstrate the trivial importance of procedural norms in the decision-making process on tax payment. Procedural fairness failed to significantly improve tax compliance. This finding is different from Tyler's theory of procedural justice.

Does Procedure Provide a Cushion of Support?

One of the most important contributions of procedural justice theory is that the positive evaluation of procedure contributes a 'cushion of support' to alleviate negative emotions when other variables are quite unfavourable.²⁸³ The result is depicted in Table 15. I find, however, that procedural norms failed to be a cushion of support. When a business taxpayer had high opportunity to evade tax and perceived negative substantive norms, it aggressively evaded taxes by deceiving most input and output values, even though the procedure was positively rated. There were 13 such cases in my sample. Taxpayers engaged in aggressive evasions even though they positively evaluated the local tax authorities. Their compliance behaviour might result from the high opportunity to evade and negative perceptions of substantive norms.

²⁸³ See Tom Tyler, *Why People Obey the Law* (Yale University Press 1990); Kristina Murphy, Tom Tyler and Amy Curtis, 'Nurturing Regulatory Compliance: Is Procedural Justice Effective When People Question the Legitimacy of the Law?' (2009) 3 *Regulation & Governance* 1, 26; Kristina Murphy and Adrian Cherney, 'Understanding Cooperation with Police in a Diverse Society' (2012) 52 *British Journal of Criminology* 181, 201.

Table 15. The Overall Cushioning Effects of Procedural Norms in the Two Cities

Opportunity to evade	Substantive norms	Procedural norms	Non-compliance		Compliance	
			Lower	Higher	Lower	Higher
High	Negative	Positive	16	0	0	0
High	Negative	Negative	9	0	0	0
High	Positive	Negative	0	0	1	0
Low	Positive	Negative	0	0	0	2

Note: Neutral evaluations are not included.

On the other hand, if business taxpayers perceived positive substantive norms, the negative procedural norms were unlikely to undermine tax compliance. There were two such cases in City Q. Norkey, a medium-sized company, specialized in producing and selling shoe soles for the domestic market. It had high opportunity to evade taxes because more than half of its materials suppliers failed to provide input invoices and most of its clients did not demand output invoices. Moreover, the owner of Norkey (Q33) evaluated the local tax authorities negatively.

Q: Do you think tax authorities treat every taxpayer equally? [*Measuring equal treatment*]

Norkey: I do not think so. They listen to large companies more than us. And, you know, large companies paid many more taxes than small businesses. We are just small potatoes.

Q: Do you think they are polite and respect you? [*Measuring dignity*]

Norkey: I do not feel that I am respected by them.

Q: Do you think they are fair? [*Measuring trustworthiness*]

Norkey: No [*shakes his head strongly*]. You know, we cannot live without *guanxi* in China.

The conversation shows that the owner of Norkey did not really trust tax authorities. The company had a higher compliance level, however, because it aimed to be listed. The owner tried to get more funding, to generate a reputation in the community and a voice in local government. His ultimate goal was to maximize the long-term interests for his company. He thus had more positive feelings on substantive norms of paying taxes.

In the case of Shaw (Q34), a medium-sized company, the financial manager perceived rampant corruption and arbitration on the part of tax officials. The company fully complied with the tax law, however, mainly because it had lower opportunity to evade and positive substantive fairness. This indicates that when substantive norms are positive, the negative procedural norms will not erode tax compliance.

Negative Procedural Norms and Tax Evasion

Though positive procedural norms mattered little, negative procedural norms seemed to undermine tax compliance. Of 14 taxpayers who indicated negative procedural norms in City Q, 13 stated non-compliance, nine had a low compliance level and four had a high compliance level (Table 14). The 13 taxpayers had high opportunity to evade and perceived substantive norms negatively. Table 15, however, illustrates that when the opportunity to evade was low and substantive fairness was

perceived to be positive, negative procedural norms did not undermine tax compliance significantly. There were two such companies.

Therefore, the preliminary results discussed above show that negative procedural norms might contribute to lower tax compliance when other factors are also unfavourable. In contrast, when other factors are favourable, negative procedural norms cannot undermine taxpayers' behaviours. All these issues reinforce the argument that procedural norms play little role in enhancing tax compliance.

The Significance of Substantive Norms

Table 16 reveals the interactions between substantive norms and tax compliance. The compliance levels for those who had negative substantive norms (43 per cent) were lower overall. Compliance was higher among those taxpayers who had positive substantive norms when they had lower opportunity to evade taxes. In contrast, positive substantive norms had a stronger effect on compliance levels even though the opportunity to evade was higher. There were three such cases in my sample.

Table 16. The Association of Substantive Norms and Tax Compliance

Opportunity to evade	Substantive fairness	Non-Compliance		Compliance	
		Lower	Higher	Lower	Higher
High (N=24)	Positive	0	0	1	0
	Negative	23	0	0	0
Low (N=26)	Positive	0	0	0	2
	Negative	0	24	0	0

Note: The four neutral evaluations are excluded.

All the explanations share one thing in common. Though seemingly surprising, there is no obvious relationship between procedural norms and tax compliance among

private businesses in the two south-eastern cities in China. Instead, substantive norms were more significant in shaping taxpayers' behaviours than the structural opportunity to evade.

Why do Procedural Norms Matter Little in China?

Procedural norms have been shown to be ineffective for nurturing VAT compliance among taxpayers in southeast China. This impels us to reconsider the boundary of procedural norms. Why might procedural norms matter little to taxpayers in southeast China? In this section, I offer some preliminary speculations.

Based on existing studies, the underlying cause might be the different regulatory contexts or cultures, which focus more on substantive norms than on procedural norms. The theory of procedural norms is built on a group value model or group identification model,²⁸⁴ which assumes that 'individuals in groups are more likely to put aside their own self-interest and act in a way that helps all group members than pure self-interest and act in a way that helps all group members than pure self-interest models would predict.'²⁸⁵ The value of procedural norms is that when people feel they are treated fairly by authorities, 'their sense of self-worth is bolstered and their attachment to the group is reaffirmed.'²⁸⁶ In contrast, if authorities behave unfairly, it

²⁸⁴ Tom Tyler, 'The Psychology of Procedural Justice: A Test of the Group-Value Model' (1989) 57 *Journal of Personality and Social Psychology* 830, 838.

²⁸⁵ Allan Lind and Tom Tyler, *The Social Psychology of Procedural Justice* (Plenum Press 1989) 230.

²⁸⁶ Kristina Murphy, 'Fostering Cooperation with the Police: How Do Ethnic Minorities in Australia Respond to Procedural Justice-Based Policing?' (2011) 44 *Australian & New Zealand Journal of Criminology* 235, 257.

can reduce the extent to which people feel socially committed to the members of society. Such assumption of procedural norms, however, 'may be effective only if authorities represent a group with which people identify'.²⁸⁷ Brockner et al, for instance, argued that in low power distance cultures, which 'people in positions with legitimate decision-making power are more likely to share their power with those in lower power position', people are more likely to concern about whether they have voice in decision processes.²⁸⁸

Examining whether power distance moderate the influence of quality of treatment, Tyler et al. suggest that when people evaluate authorities, those with lower power-distance values, who have stronger social connections with authorities and the institutions they represent, place more weight on the quality of their treatment by authorities. In contrast, those with higher power-distance values, who are more impersonal and role constrained, focus more on the favourability of outcomes.²⁸⁹ Drawing on a random sample of African Americans, Latinos, and Whites, Huo suggested that those who are highly identified with the superordinate category of

²⁸⁷ Yuen Huo, Heather Smith, Tom Tyler and Allan Lind, 'Superordinate Identification, Subgroup Identification, and Justice Concerns: Is Separatism the Problem; Is Assimilation the Answer?' (1996) 7 *American Psychological Society* 40, 45.

²⁸⁸ Joel Brockner, Grant Ackerman, and Jerald Greenberg et al, 'Culture and Procedural Justice: The Influence of Power Distance on Reactions to Voice' (2001) 37 *Journal of Experimental Social Psychology* 302.

²⁸⁹ Tom Tyler, Allan Lind and Yuen Huo, 'Cultural Values and Authority Relations: The Psychology of Conflict Resolution across Cultures' (2000) 6 *Psychology, Public Policy, and Law* 1138, 1163.

America indicated greater concerns on procedural norms.²⁹⁰ Another more recent study from Murphy and Cherney also proved this argument.²⁹¹ Using survey data collected from Australian citizens, they found that procedural norms were less effective in nurturing cooperation among ethnic minorities than majority group members. The reason might be that ethnic minorities were less identified with the superordinate category of Australia.

The impact of procedural norms on tax compliance behaviour, therefore, might be neglected in a society where taxpayers have few concerns about identity or did not share the similar cultural values. That is, group values might be the premise that makes procedural fairness work.

The second speculation is that the procedural norms might not work directly on compliance in China, instead, it works through some other factors, such as legitimacy²⁹² or emotion.²⁹³ The previous studies presented both direct and indirect effects of procedural norms on compliance. In Tyler's classic study *Why People Obey*

²⁹⁰ Yuen Huo, 'Procedural Justice and Social Regulation across Group Boundaries: Does Subgroup Identity Undermine Relationship-Based Governance?' (2003) 29 *Personality and Social Psychology Bulletin* 336, 348.

²⁹¹ Kristina Murphy, 'Fostering Cooperation with the Police: How Do Ethnic Minorities in Australia Respond to Procedural Justice-Based Policing?' (2011) 44 *Australian & New Zealand Journal of Criminology* 235, 257.

²⁹² Tom Tyler, *Why People Obey the Law* (Yale University Press 1990).

²⁹³ Kristina Murphy, 'Procedural Justice and Its Role in Promoting Voluntary Compliance' in Peter Drahos (ed) *Regulatory Theory: Foundations and Applications* (Australian National University Press 2017) 53,54

the Law, he argued that legitimacy was central in shaping compliance and procedural justice was associated with compliance. However, in their later work, Tyler et al proved that procedural justice had independent effect on cooperation separate from legitimacy.²⁹⁴ Other studies, such as Murphy et al and Huq et al also found the direct effects of procedural norms on nurturing compliance.²⁹⁵ After reviewing on the relevant studies, Nagin and Telep argued that the statistical results did not create an adequate basis for supporting the positive association between legitimacy and compliance, between legitimacy and procedural justice, and between procedural justice and compliance.²⁹⁶ It seems that the linkage between procedural norm and compliance are unsure based on existing studies.

²⁹⁴ See Kristina Murphy, Tom Tyler and Amy Curtis, 'Nurturing Regulatory Compliance: Is Procedural Justice Effective When People Question the Legitimacy of the Law?' (2009) 3 *Regulation & Governance* 1, 26; Kristina Murphy, 'Procedural Justice and the Regulation of Tax Compliance Behavior: The Moderating Role of Personal Norms' in James Alm, Jorge Martinez-Vazques and Benno Torgler (eds), *Developing Alternative Frameworks for Explaining Tax Compliance* (Routledge 2010) 191, 214; Tom Tyler, Stephen Schulhofer and Aziz Z. Huq, 'Legitimacy and Deterrence Effects in Counterterrorism Policing: A Study of Muslim Americans' (2010) *Law & Society Review* 365, 401.

²⁹⁵ Aziz Z Huq, Tom Tyler and Stephen Schulhofer, 'Why Does the Public Cooperate with Law Enforcement? The Influence of the Purpose and Targets of Policing' (2011) 17 *Psychology, Public Policy, and Law* 419, 450.

²⁹⁶ Daniel Nagin and Cody Telep, 'Procedural Justice and Legal Compliance' (2017) 13 *Annual Review of Law and Social Science* 1, 24.

Another speculation is that procedural justice might work more effectively on cooperation, acceptance of the decisions, and the willingness to comply, instead of compliance decision or behaviour. As Tyler and Huo mentioned in 2002:²⁹⁷

..., procedural justice and motive-based trust had little influence on compliance, but as we have already shown, they did have a large influence on acceptance...the psychology of voluntary acceptance should be distinguished from the psychology of involuntary compliance.

Unfortunately, the current research often mixed the effects of procedural justice on cooperation and compliance. We cannot know whether procedural norms play the similar roles on the both.

This section offers three reasons that might explain the trivial significance of procedural norms in shaping tax compliance in China. I speculated that the Chinese high power distance culture, which refers to that high power people who enjoyed the decision power would not like to share it with the lower power people, made people concern more about the outcome-based norms instead of procedural norms. I also argue that procedural norms might work on compliance indirectly through other factors, and procedural norms might work more effectively only on cooperation, acceptance of decisions, and satisfaction instead of compliance.

²⁹⁷ Tom Tyler and Yuen Huo, *Trust in the Law: Encouraging Public Cooperation with the Police and Courts* (Russell Sage Foundation 2002) 82.

Conclusions

This chapter focuses on analysing how procedural norms influence business compliance behaviour in southeast China. The results show no obvious causal link between procedural norms and tax compliance. Procedural norms fail to become a cushion of support to mitigate the effects of other unfavourable factors. Instead, substantive norms, which refer to people's perceptions on the outcome fairness and the distribution of resources, are more important in shaping compliance than opportunities to evade.

Tyler	Skogan	This Study
Significant correlation	Asymmetric correlation	No significant correlation

Figure 11. What Tyler, Skogan, and This Study Compare

This chapter extends the understanding on the role of procedural norms. It found that procedural norms has little link to tax compliance among private businesses in southeast China. The result, however, violated the long-term accepted notion that procedural norms is central in nurturing compliance (Figure 11). It seemed that negative procedural norms did not undermine tax compliance. Skogan's notion of asymmetric correlation of procedural norms on compliance is thereby not supported.²⁹⁸ Based on the current studies, I speculated that Chinese taxpayers focused more on substantive norms might be because people had less connections and supports for the authorities. The society lacked a value of identification to make

²⁹⁸ Wesley G. Skogan, 'Asymmetry in the Impact of Encounters with Police' (2006) 16 *Policing & Society* 99, 126.

people committed to the institution and authorities. Procedural norms might not work directly on compliance, and it might be more central in enhancing cooperation instead of compliance. Further researches are needed to identify the conditions that are associated with procedural norms to tax compliance.

Chapter Five. Why Are They Unwilling to Pay Tax?

Widespread weak substantive norms, as the last chapter has shown, undermine tax compliance significantly. This chapter intends to probe the underlying reasons behind the weak substantive norms. How have the substantive norms of tax evasion been shaped among business taxpayers in south-east China?

Tax compliance research has long been focused on substantive aspects of taxation. The first aspect is individual norms by which taxpayers evaluate their tax level relative to their income levels. A survey conducted among taxpayers in the southwest of England by Calderwood and Webley found that taxpayers considered it reasonable to evade taxes when they were trying to make a living for their families.²⁹⁹ This is in line with the notion of moral dilemma in Gezelius and Hauck's study of fishery regulation.³⁰⁰

Taxpayers might evaluate their tax burden compared to other taxpayers who are in the same economic situation. This would be a case of horizontal norm. In their classic study, Spicer and Becker found that taxpayers who feel victimized

²⁹⁹ Gary Calderwood and Paul Webley, 'Who Responds to Changes in Taxation? The Relationship between Taxation and Incentive to Work' (1992) 13 *Journal of Economic Psychology* 735, 748.

³⁰⁰ See Robert Kagan, Neil Gunningham and Dorothy Thornton, 'Fear, Duty, and Regulatory Compliance: Lessons from Three Research Projects' in Christine Parker and Nielsen Vibeke (eds), *Explaining Compliance: Business Response to Regulation* (Edward Elgar Publishing 2011) 37, 58; Stig Gezelius and Maria Hauck, 'Toward a Theory of Compliance in State-Regulated Livelihoods: A Comparative Study of Compliance Motivations in Developed and Developing World Fisheries' (2011) 45 *Law & Society Review* 435, 470.

(disadvantaged) will increase tax evasion, but those who feel favoured (advantaged) will decrease tax evasion.³⁰¹ Dean et al. also found that a perception of horizontal inequity is very prevalent in Scotland.³⁰² Kinsey and Grasmick reported evidence that horizontal equity plays a role in tax compliance.³⁰³ Some studies, however, found no significant effect of horizontal justice on tax compliance level.³⁰⁴

Taxpayers may also compare their tax burden with others who are in different boats. In the study by Kinsey and Grasmick, for instance, American taxpayers believed that the tax system (after the Tax Reform Act of 1986) favoured the rich and thus accepted tax cheating.³⁰⁵

‘Taxes have always been an important source of potential stress in the interface between a citizen and his government.’³⁰⁶ A large body of research has presented evidence that positive fiscal exchange nurtures tax compliance.³⁰⁷ Alm et al. showed

³⁰¹ Tom Spicer and Lee Becker, ‘Fiscal Inequity and Tax Evasion: An Experimental Approach’ (1980) 33 *National Tax Journal* 171, 175.

³⁰² Peter Dean, Tony Keenan and Fiona Kenney, ‘Taxpayers’ Attitudes to Income Tax Evasion: An Empirical Study’ (1980) 25 *British Tax Review* 28, 44.

³⁰³ Karyl Kinsey and Howard Grasmick, ‘Did the Tax Reform Act of 1986 Improve Compliance? Three Studies of Pre- and Post- TRA Compliance Attitudes’ (1993) 15 *Law & Policy* 239, 325.

³⁰⁴ Robert Mason and Lyle Calvin, ‘A Study of Admitted Income Tax Evasion’ (1978) 13 *Law & Society Review* 73, 90.

³⁰⁵ Karyl Kinsey and Howard Grasmick, ‘Did the Tax Reform Act of 1986 Improve Compliance? Three Studies of Pre- and Post-TRA Compliance Attitudes’ (1993) 15 *Law & Policy* 239, 325.

³⁰⁶ Michael Spicer and Lee Becker, ‘Fiscal Inequity and Tax Evasion: An Experimental Approach’ (1980) 18 *National Tax Journal* 171, 175.

³⁰⁷ See Joachim Vogel, ‘Taxation and Public Opinion in Sweden: An Interpretation of Recent Survey

that taxpayers may pay taxes because they value the public goods and services provided by the government.³⁰⁸ Examining the development levy in Tanzania, Fjeldstad and Semboja suggested that people's tax resistance is correlated to deteriorating or non-existent public services.³⁰⁹ This result, however, is not consistent with other studies.³¹⁰ In a sample survey of 800 Oregon adults, for example, Mason and Calvin asked taxpayers to evaluate their tax levels compared to the benefits they received and the result was not significantly related to any type of tax evasion.³¹¹

Most of the time, the four sources of substantive norms are studied separately. Schnellenbach, one of the rare exceptions, sketched the interplay of two types of reciprocity in decision-making tax evasion: firstly, the horizontal relationship between taxpayers and, secondly, the vertical relationship between the public sector and taxpayers. He found that the vertical norm is the starting point. Taxpayers evade taxes

Data' (1974) 27 *National Tax Journal* 499, 513; Thomas Porcano, 'Correlates of Tax Evasion' (1988) 9 *Journal of Economic Psychology* 47, 67; James Alm, Gary McClelland and William Schulze, 'Why Do People Pay Taxes?' (1992) 48 *Journal of Public Economics* 21, 48; James Alm, Betty Jackson and Michael McKee, 'Fiscal Exchange, Collective Decision Institutions and Tax Compliance' (1993) 22 *Journal of Economic Behavior and Organization* 285, 303.

³⁰⁸ James Alm, Betty Jackson and Michael McKee, 'Deterrence and Beyond: Toward a Kinder, Gentler IRS' in Joel Slemrod (ed), *Why People Pay Taxes: Tax Compliance and Tax Enforcement* (The University of Michigan Press 1992) 311, 329.

³⁰⁹ Odd-Helge Fjeldstad and Joseph Semboja, 'Why People Pay Taxes: The Case of the Development Levy in Tanzania' (2001) 29 *World Development* 2059, 2074.

³¹⁰ See Gregory Wallschutzky, 'Possible Causes of Tax Evasion' (1984) 5 *Journal of Economic Psychology* 371, 384.

³¹¹ Robert Mason and Lyle Calvin, 'A Study of Admitted Income Tax Evasion' (1978) 13 *Law & Society Review* 73, 90.

to retaliate against unfair government initially, then taxpayers' evasions increase if they believe that other taxpayers have also evaded.³¹² This finding is consistent with an earlier framework developed by Pommerehne et al., who pointed out that tax evasion is lower when taxpayers are motivated by civic duty in direct democracies.³¹³ Following Schnellenbach's framework, Bazart and Bonein proved that when both inequities came into play, the horizontal always dominated the vertical³¹⁴—that is, taxpayers' decision on tax evasion tends to conform to others'.³¹⁵

Four dimensions of substantive norms were examined in the two cities (Table 17). The individual norm canters on the reciprocity of the individual ability to pay taxes and the tax burden (tax rates). The horizontal and vertical norms focus on the reciprocity of taxpayers themselves and others. The exchange norm examines the reciprocity between the government and taxpayers. There are also some other categories of substantive norms. Schnellenbach defined the norms as reciprocity between taxpayers and their governments, and between taxpayers and the other

³¹² Jan Schnellenbach, 'Vertical and Horizontal Reciprocity in a Theory of Taxpayer Compliance' in James Alm, Jorge Martinez-Vazquez and Benno Torgler (eds), *Developing Alternative Frameworks for Explaining Tax Compliance* (Routledge 2010) 56, 73.

³¹³ Werner Pommerehne, Albert Hart and Bruno Frey, 'Tax Morale, Tax Evasion and the Choice of Policy Instruments in Different Political Systems' (1994) 49 *Public Finance [Finances Publiques]* 52, 69.

³¹⁴ Cécile Bazart and Aurélie Bonein, 'Reciprocal Relationships in Tax Compliance Decisions' (2014) 40 *Journal of Economic Psychology* 83, 102.

³¹⁵ See also Michael Wenzel, 'Misperceptions of Social Norms about Tax Compliance: From Theory to Intervention' (2005) 26 *Journal of Economic Psychology* 862, 883.

taxpayers.³¹⁶Wenzel, for instance, grouped substantive norms into personal and social norms. Personal norms are defined as individual's internalized tax honesty. Social norms are defined as the externalized tax morality of social groups.³¹⁷ In general, researches understand substantive norms in different ways according to the need of their research.

Since this chapter focuses on the substantive norms among those non-compliant taxpayers, three compliance cases are excluded (Norkey Q33, Shaw Q34 and Pace Q35). Following Spicer and Becker's concepts, I label those negative perceptions as disadvantaged and positive perceptions as advantaged. Taxpayers are divided into two groups: lower compliance and higher compliance. This chapter examines the effects of the four types of substantive norms among Chinese taxpayers, the underlying reasons and how they come into play to shape the negative reciprocity in general.

³¹⁶ Jan Schnellenbach, 'Vertical and Horizontal Reciprocity in a Theory of Taxpayer Compliance' in James Alm, Jorge Martinez-Vazquez and Benno Torgler (eds), *Developing Alternative Frameworks for Explaining Tax Compliance* (Routledge 2010) 56, 73.

³¹⁷ Michael Wenzel, 'The Social Side of Sanctions: Personal and Social Norms as Moderators of Deterrence' (2004) 28 *Law and Human Behavior* 547, 567.

Table 17. Substantive Norms among Non-Compliant Taxpayers in the Two Cities

	Substantive norms (N=51)		
	Yes/Disadvantaged	No/Advantaged	Don't Know
Individual norms <i>Do you feel that you pay too much relative to your income?</i>	29(57%)	22(43%)	0(0%)
Horizontal norms <i>Do you feel that you pay more than taxpayers Who are in the same boat as you?</i>	9(18%)	39(76%)	3(6%)
Vertical norms <i>Do you feel that you pay more than larger companies?</i>	10(20%)	34(67%)	7(14%)
<i>Do you feel that you pay more than smaller companies?</i>	24(47%)	22(43%)	5(10%)
Exchange norms <i>Do you feel that you pay more taxes than all social benefits you received?</i>	41(80%)	10(20%)	0(0%)

Horizontal Norms: Everyone Is Evading

Table 17 shows that 18 per cent of respondents (9 out of 51) felt that they paid more taxes than other taxpayers who were in the same boat, while 76 per cent (39 out of 51) perceived horizontal equity—that means, taxpayers believed that other taxpayers evaded taxes in the same way. The widespread negative horizontal norm failed to nurture feelings of guilt; instead, it pushed taxpayers to take a stance towards evasion.

Those who were audited and punished might feel unfair because other taxpayers were still evading taxes. Every year, the annual campaigns to combat illegal input invoices detect violations in various industries. The campaign focused on the shoe and textile industry in 2016. Simba (Q17) was caught because of an illegal input tax invoice issued from a shell company in Jiangxi Province. It was not allowed to deduct

input tax for several transactions, was required to pay the taxes owed with interest, and was issued a further fine of the amount of the taxes owed. The total amount was around 400,000 RMB. The owner told us about a fight between him and a tax official when the company was notified that it should pay taxes owed because of keeping illegal input tax invoices.

The tax official said loudly: “Why did you accept illegal input tax receipts? You could have cooperated with someone who could issue you legal tax receipts!”

The owner was angry and said: “If you can make sure that everyone is paying taxes honestly, I will also obey the law. Otherwise, you tell me, how can I survive? After sometime, my company will close down!”

Therefore, when law enforcement is unable to eliminate all tax evasion, cracking down on one or two might increase the tax burden, and thus generate hatred and resistance. Deterrence was also ineffective because taxpayers follow the norm of evasion after being punished.

Vertical Norms: Ambiguous Messages

The vertical norms examines how taxpayers perceived their tax burden compared to others in different economic situations. I asked taxpayers how they perceived the difference between the taxes that they paid and the taxes that larger or smaller companies paid. Of the informants, 67 per cent felt that they paid the same as or less than large companies, 20 per cent thought that they paid more than large companies,

and 14 per cent did not know. Two informants expressed contrasting opinions on this question.

Large companies always pay less than small companies. Their tax burden rate is lower than ours...The government also gives refund to large companies (New Nam Q15).

Of course large companies pay more than us. They are more compliant. Especially those who are listed companies would like to pay more taxes to show that they are legalized and well operated (Deer Q2).

It was hard to recognize which message was correct in practice. The distinct opinions, however, came from taxpayers' experience and information; 14 per cent reported that they actually had no idea about it because they rarely obtained the information. It reinforced that taxpayers should have sufficient information to help them evaluate vertical norms.

Taxpayers were also unsure about whether they paid more than small companies or not: 43 per cent had positive perceptions, 47 per cent had negative perceptions and ten per cent did not know. Unregistered and evaded businesses that could provide lower price intensified the competition. The owner of Merry (Q12) complained that:

Compared with unregistered companies, we have more costs and risks. Why do tax authorities allow them to compete with us? I don't understand.

Government institutions of safety, tax, and hygiene often inspect on us. They

never bother those unregistered companies. Actually, they are more dangerous and aggressive than us.

The owner of Lion (Q10) was also unhappy about it:

Tax authorities only monitor those honestly registered companies. My upstairs was rented to an unregistered company. It never paid taxes and other fees. We comply with law, but we suffer losses (吃虧). The ineffective regulations on unregistered companies make the law-abiders feel fool.

The results show that vertical norms might play a role, but can be influenced by the accessibility and accuracy of the information that taxpayers obtain and how taxpayers understand the information.

Exchange Norms: Paying Taxes Is Useless

The more governments stick to the benefit principle of taxation and provide public services in exchange for a reasonable tax price, the more taxpayers are willing to comply with tax laws.³¹⁸ The benefits consist of material and non-material rewards. Material rewards normally refer to a tax refund or tax subsidizes and social welfare. Non-material benefits involve public services, reputation, social resources, tax incentives, funding and facilities support, to name a few.

The way and that governments use taxpayers' money and the quality of the services provided is one of the most important aspects of the exchange norm. Four

³¹⁸ See Lars Feld and Bruno Frey, 'Tax Compliance as the Result of a Psychological Tax Contract: The Role of Incentives and Responsive Regulation' (2007) 29 Law & Policy 102, 120.

dimensions were surveyed in City Q and City S. In total, 50 informants answered the questions. In City Q, 40 per cent of the respondents answered that in their view tax was only partly or not at all used to provide public services, compared to 17 per cent in City S. However, a total of 23 out of 50 taxpayers (46 per cent) reported that they had no way of knowing whether the money was used for public services in the two cities. In respect of the quality of local government services, satisfaction was much higher in City S, where 60 per cent of respondents considered the quality to be good (compared to 25 per cent in City Q), 37 per cent considered them average (45 per cent in City Q) and none considered them bad (15 per cent in City Q). The respondents' perceptions of how the government spends money were quite ambiguous in the two cities. There were 46 per cent (23 out of 50) taxpayers who had no idea about the way the government spends money. In City Q, 45 per cent of respondents said they were willing to pay more taxes if the public services were improved; 20 per cent of the respondents expressed a reservation that it depended on their ability to pay; the other 20 per cent of respondents were unwilling to pay more taxes because they felt that the tax burden was already very heavy.

The results delivered conveyed two messages. On the one hand, the hypothesis about a positive relationship between the use of tax revenues and compliance behaviours is not supported, but it can explain why taxpayers were not willing to pay taxes. On average, taxpayers were not satisfied with the fiscal exchange. On the other hand, the fiscal exchange would have little outcome if taxpayers did not participate in

decision-making on expenditure or if governments failed to convey the message to the taxpayers, even though governments might in fact provide good services.

Table 18. Taxpayers' Evaluations on Public Services in the Two Cities

	City Q (N=20)				City S (N=30)			
	Negative	Neutral	Positive	Don't Know	Negative	Neutral	Positive	Don't Know
Do you consider that tax revenues collected in your place are used to provide public services?	8 (40%)	4 (20%)	2(10%)	6(30%)	5(17%)	3(10%)	5(17%)	17(57%)
How do you rate the quality of local government services (e.g. roads, education, health services, etc.) in your place?	3(15%)	9(45%)	5(25%)	3(15%)	0(0%)	11(37%)	18(60%)	1(3%)
How dissatisfied or satisfied are you with the way the government spends taxpayers' money?	4(20%)	7(35%)	1(5%)	8(40%)	4(13%)	6(20%)	5(17%)	15(50%)
Would you be willing to pay more taxes if the public services were improved?	4(20%)	4(20%)	9(45%)	3(15%)				

Note: The fourth dimension was not evaluated in City S.

How do taxpayers consider the social benefits they received compared to the taxes they paid? Of 50 informants, 80 per cent felt that all social benefits they received were much lower than the taxes they paid. Only 20 per cent evaluated this positively because either they paid a small amount of taxes or they were relatively large companies (Table 17). Taxpayers were most concerned about financial support. Many of them cried that governments had taken a lot away from them but given nothing back.

Indeed, small and medium-sized companies enjoyed little support from the society and governments. They were unable to obtain formal finance from the local

bank because banks preferred to give loans to larger companies on the one hand, and small businesses were difficult to provide mortgages to on the other. A client manager of a local bank told me that they decided to give loans based on several factors including premises area, number of workers, the amount of monthly electricity used, annual turnover, market position, etc.

Bumblebee was worried about how to get a loan from the bank. Due to their good quality and fashionable style, Bumblebee's shoes were popular on the market. In recent years, though, the local shoe market has shrunk greatly, and the company's business costs went up. At the end of 2015, Bumblebee invested 10 million RMB to buy land and built new premises covering 60 acres. The new land, however, had no title because that meant the company should pay a land lease fee of around 24 million (0.4 million per acre) to the local government. When it tried to apply for a loan from a local bank, it was told that it could not get a loan without a mortgage. To save the land lease fee or to get a loan was a problem. The financial manager chuckled:

We are not state-owned companies who have strong backup. Where is the money from if we do not save [by evading taxes]?

The owner of King (Q14) complained:

The central government keeps vowing support for small and medium-sized companies. Nothing was there. Banks only loan to larger companies. Local governments subsidize large companies. [...] If one throws a stone in the river, there are ripples. But if one pays taxes, nothing occurs, virtually

nothing. [...] We are so pathetic. We provide jobs for migrant workers. We pay large amounts of taxes. We small and medium-sized firms contribute a lot to the country [...] but when we are in trouble, no one is behind us. We are always on our own.

The same problems occurred in City S. Mr Zhu (S31), the tax preparer of the 30 companies I interviewed, also provided informal financial resources for his clients.

Compared to the larger companies, who enjoyed plenty of finance from banks and had more negotiable power to bargain for land and resources from the local governments, small and medium-sized companies relied on themselves.

Individual Norms: Happy and Angry Birds

Individual norm examines how taxpayers perceived their tax burden relative to their income. The results show that 57 per cent of taxpayers perceived the individual norm to be to their disadvantage; however, 43 per cent of taxpayers felt that they did not pay too much tax. Both perceptions contribute to tax evasion. The remaining part will explain the reasons for disadvantaged and advantaged norms, respectively.

The Disadvantageous Norms

The taxpayers who perceived disadvantageous norms have mixed mental account of VAT. According to VAT law, VAT should be paid when the amount of output VAT is more than the input VAT, even though businesses might lose money. 'Tax revenue is secured by being collected throughout the process of production (unlike a

retail sales tax) but without distorting production decisions.’³¹⁹ Except for the cost of production (raw materials, components or services), other costs including wages, administration fees and rent, to name a few, are ignored. On paper, VAT is designed as a separate part of business turnover because the money that is paid will be transferred to consumers eventually.

The statement “we paid too much” was often heard during my investigations. The dissatisfaction stemmed from taxpayers’ mixed mental account of VAT. When businesses failed to gain profits or did not know whether they were going to earn money, the majority subsequently disliked handing tax over.

Steam: The VAT burden is very high. Our profit, however, is marginal. I worked so hard throughout the year, only little money left in my pocket. Raw materials, rent, and electricity and water became much more expensive than previous years, but the price of products we made did not increase. The majority of these costs were not deducted in VAT calculations (S18).

Yao: You need to calculate labour wages, rent, electricity and water fees, etc. They are part of costs that were completely forgotten (S19).

Entel: My company should have at least 2.2 million turnover per month to make ends meet. Except for January, March and April, I lost money in the

³¹⁹ Richard Bird and Gendron Pierre-Pascal, *The VAT in Developing and Transitional Countries* (Cambridge University Press 2007) 10.

other months with only 1.7 to 1.8 million turnover on average. But I am still paying a big amount of VAT (S26).

Youth: For example, I am assembling a phone. We buy raw materials at 60 dollars. The labour cost, however, is 40 dollars. Labour cost is not allowed to be included in input credits. My strategy is to buy more input invoices to reduce the amount of VAT. Businesses evade tax because they try to survive in the competitive market...The fewer costs, the better (Q13).

The taxpayers presented above focused on how much money they had earned. They did not consider VAT separately but as part of their income which would be taken from their pockets and not returned. The entrenched idea was shaped by the meagre income and high VAT rate.

On the one hand, a highly competitive market motivated taxpayers to evade taxes. It meant that they should lower their costs as much as possible. In a labour intensive industry, a cheap price is the most useful weapon for them to occupy the market. The homogenization of products and management aggravated competition. In City Q, small and medium-sized companies replicated the operational styles, shoes styles, logos and names of local or global famous companies. The corporate names—for instance, Anpu, Kangta or Zuta—were similar to Anta, which is the most successful branded company in City Q. Their logos were also fairly similar to the logo of Anta.

The VAT rate was too high for taxpayers to handle. Small and medium-sized companies often encountered a funds shortage. The dialogue between the part-time tax preparer Mr Zhu (S31) and the owner of Xinqi (S11), a machine tool manufacturer established in 2014, shows the meagre profits and financial problems of the company.

Xinqi: I paid a large amount of wages for my workers.

Zhu: Rent and electricity and water fees are not allowed to be deducted because you do not have tax invoices.

Xinqi: Can I deduct wages? They [tax officials] will know how much I have paid from the bank.

Zhu: No, you cannot deduct them in VAT calculations.

Xinqi: The amount of wages I paid is more than 30 per cent of turnover ... Raw materials accounted for 40 per cent ... Rent and electricity and water fee accounted for less than five per cent ... Five per cent went on wasted materials, two per cent on administration fees.

Zhu: About ten per cent went on taxes—nine per cent was for VAT, and one per cent for other taxes. So your net profit was about eight per cent. It was not bad. But we neglected financial interest of loans. More importantly, clients owed money for a long time.

Xinqi: Very long, four to six months, sometimes even a year. We have a very serious cash flow problem.

Xinqi was not alone in my sample of 65 businesses. The average net profit, for instance, was about 6.47 per cent among 35 shoe companies in City Q. Due to the high tax burden, taxpayers treated tax evasion as the only solution to survive.

Tax burden is too high, we cannot survive (Martin, Q11).

We actually work for the government (Fortune, Q24).

All business owners are struggling for survival. Sometimes we gave up deals only because we could not earn money (Energy, Q27).

If we pay one penny less, we earn one penny more. If we pay one penny more, we lose one penny more (Super, Q26).

Social constraints also increase the tax burden. On paper, taxpayers should obtain legal and formal tax invoices as evidence of inputs. In practice, however, businesses were unable to achieve the tax invoices. If taxpayers failed to achieve the invoices, they were not allowed to deduct it from VAT liability. Mr Zhu (S31), an experienced tax preparer among the 30 interviewees in City S, explained:

Unlike large companies, small businesses find it difficult to achieve tax invoices. Take electricity and water fees as an example. The majority of my clients rented private buildings as premises. The building was shared by four to five companies. But there was only one ammeter and water meter which were under the name of landlord. Due to the threshold of quantity, they could not apply for a separate ammeter and water meter. They thus could not receive separate tax invoices for electricity and water. In addition, tax

invoice of rent was unavailable in most private premises which had no certificates of title. These private buildings, however, offered cheaper prices for small and medium-sized companies to do business.

Due to the disadvantageous norms, taxpayers were compelled to evade the VAT. The widespread evasions, however, reinforced individual norms, and thus generated a vicious circle. Taxpayers said that they were forced to evade taxes otherwise they were unable to survive in the market. As the financial manager of Laden (Q29) had put it:

For example, two companies make the same shoe with same quality. One pays VAT and offers shoe price at 100 RMB while the other one evade VAT and offers shoe price at 98. The former one will not get any orders. Finally, it will bankrupt.

The Advantageous Norms

Contrary to the disadvantaged norm, taxpayers who perceived advantageous norms did not complain about the competitive market environment and high tax burden: instead, they were happy with the current situation. These taxpayers normally had good annual turnovers and paid a very small amount of taxes in relation to the tax liability. They kept a long distance from the law and tax authorities. Hero (Q5), established in 2000 in City Q, is a shoe materials wholesaler, with an annual turnover of 30 million RMB but only reporting 0.47 million to the local tax authority in 2016. Founded in 2014 in City S, Liti (S3) is a construction company. It reported an annual

turnover of 5 million in 2016, half of its actual turnover. The owners of Hero and Liti answered the question about individual equity in a very similar tone.

Q: Do you feel that you pay too much in relation to your income?

Hero: It depends on how you evade taxes. If you evade many, then your tax burden will be low.

Liti: We actually did not pay so much tax. So it is hard to say. I think taxes are not so high for my company.

The Interplay of the Norms

The forms of substantive norms, however, do not work separately. Instead, they interface with each other to shape the overall substantive norms. This section tries to examine the relationships between the norms (Figure 12).

The individual norms that considers the reasonableness of the amount of taxes in relation to income was the decisive factor.³²⁰ Other norms took effect through the individual norm. Weak internal reciprocity made taxpayers less likely to support the content of the tax law. When I asked them to what extent they agreed that tax evasion was not the right thing to do, many of them said that evading taxes is wrong but

³²⁰ Cf. Michael Wenzel, 'An Analysis of Norm Processes in Tax Compliance' (2004) 25 *Journal of Economic Psychology* 213, 228; Jan Schnellenbach, 'Vertical and Horizontal Reciprocity in a Theory of Taxpayer Compliance' in James Alm, Jorge Martinez-Vazquez and Benno Torgler (eds), *Developing Alternative Frameworks for Explaining Tax Compliance* (Routledge 2010) 56, 73.

paying too much tax is also wrong. Taxpayers were in a moral dilemma of paying taxes and losing money, or not paying them and surviving.

The exchange norms positively related to the individual norms. As expected, taxpayers received few social benefits from paying taxes, and thus felt less moral motivation to comply with the tax laws. On the other hand, taxpayers perceived more unfairness about fiscal exchange if they were under the weak individual norm of compliance—that is, heavy tax burden and poor economic performance would increase their dissatisfaction in their fiscal contract with the government. Different from Schnellenbach, who argued that the exchange norms are the starting point, this study found that dissatisfaction with the fiscal contract and high tax burden rate were two factors that led to a rampant weak individual norm of tax evasion.³²¹

The individual norms are also positively related to the horizontal norm. Obviously, when several taxpayers evaded taxes in a community, the norm would be spread and became the group norms. After tax evasions were rife, this would reinforce the individual norms; therefore, newcomers would also be forced to evade taxes or naturally became disengaged.

The vertical norms contributed to the individual norm. If taxpayers found that they paid much more than larger companies or smaller companies, they would think

³²¹ Jan Schnellenbach, 'Vertical and Horizontal Reciprocity in a Theory of Taxpayer Compliance' in James Alm, Jorge Martinez-Vazquez and Benno Torgler (eds), *Developing Alternative Frameworks for Explaining Tax Compliance* (Routledge 2010) 56, 73.

the tax law system tried to benefit the others. The vertical norms, however, depended on the clearness and accuracy of taxpayers' interpretation.

The exchange norms might contribute to the vertical norms. The redistribution of resources and money increased or decreased the tax burden of a certain group. Hence, it influenced the situation of the vertical norms.

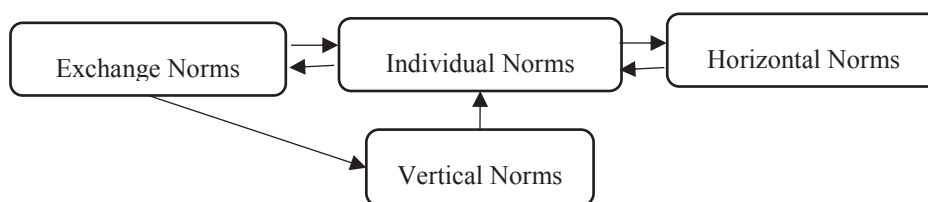


Figure 12. The Interplay of the Norms

Conclusions and Implications

Why are taxpayers unwilling to pay taxes in southeast China? This chapter examines how the substantive norms of tax evasion were shaped and how these norms interact. It finds that a weak individual norm of compliance is the most important factor. Other norms work through the individual norms. Two types of individual norms are presented: disadvantageous and advantageous. The disadvantageous norms, taxpayers perceived himself as a victim of inequity, largely resulted from high tax burden. The advantageous norms, taxpayers felt favoured due to tax evasions, largely resulted from widespread evading norms.

The common factor that attributed to the disadvantageous and advantageous norms was the exchange norms. The exchange contract between taxpayers and governments is critical to shape the individual norms. Taxpayers who were unable to participate in decision-making on public services or to access such information found

it hard to evaluate the quality and the money was spent on public services, and thus undermined the exchange contract. On the other hand, social benefits—for example, financial support and tax subsidies—were not received by the small and medium-sized taxpayers. It directly demotivated taxpayers to pay tax honestly.

Table 19. Comparisons of Braithwaite and This Study’s Explanations on Tax Defiance

	Braithwaite		This Study
	Motives		Motives
Disengagement	dissociation from authority	Advantageous norm	Widespread tax evasions; negative exchange norms
Resistance	Opposition to the way in which an authority uses its powers	Disadvantageous norm	High tax burden; negative exchange norms

Braithwaite suggested two postures determine how people defer to authority decision and rules (Table 19). Disengagement entails taxpayers’ dissociation from authority while resistance means that taxpayer opposing tax authority and accusing that they abuse their powers.³²² The major concern of Braithwaite’s explanation is the relation between taxpayers and tax authorities. Her notion of disengagement is similar to advantageous norm, and resistance is similar to disadvantageous norm. This study, however, further examined the underlying causes of disengagement and resistance in China. The negative exchange norm is their common reason. Widespread tax evasion attributed to advantageous norms. The high tax burden resulted in disadvantageous norms. Due to taxpayers’ perceptions on unreasonableness, they would resist the tax laws and authority’s directives. My study not only focused on how taxpayers

³²² Valerie Braithwaite, *Defiance in Taxation and Governance: Resisting and Dismissing Authority in a Democracy* (Edward Elgar 2003); Kristina Murphy, ‘Turning Defiance into Compliance with Procedural Justice: Understanding Reactions to Regulatory Encounters through Motivational Posturing’ (2016) 10 Regulation & Governance 93, 109.

perceived tax authorities, but also considered their evaluations on the tax system and on the quality of public goods that provided by the state.

To regulate the disadvantageous norms, China should improve the reasonableness of the VAT rates. In such circumstance, law enforcement was ineffective because taxpayers tried to oppose tax authorities. To regulate advantageous norms, tax authorities should improve the enforcement among this group of taxpayers to nurture the norm of compliance.

Chapter Six. A Typology of Tax Compliance

So far, I have discussed the roles of structural opportunity and social norms in promoting or undermining tax compliance. The empirical evidence show that both factors are important to understand tax compliance. This chapter examines how both of them work together to shape taxpayers' decisions making on compliance or evasion.

Examining tax evasion in China's shoe industry provides a point of entry into a broader conversation on compliance across different jurisdictions and businesses. Indeed, much ink has been spilled on the factors affecting compliance. Elucidating a clear framework and theory to explain what causes compliance or why it fails to garner compliance, however, is difficult. As Parker and Nielsen argue, 'the range of factors that are hypothesized to influence compliance are so complex and interrelated that is very difficult to holistically test them all, or even to clearly hypothesize how they interact and in what direction causations flows.'³²³

Understanding that it is unlikely that a single factor or motivation best explains compliance or non-compliance, scholars have developed typologies that bring together different sets of factors. Kagan and Scholtz's typology, for example, distinguishes between "amoral calculators" – firms that only comply when it is in their own economic advantage, "political citizens" – firms that comply because they

³²³ Christine Parker and Vibeke Nielsen, 'Introduction' in Christine Parker and Vibeke Nielsen (eds) *Explaining Compliance: Business Responses to Regulation* (Edward Elgar Publishing 2011)6.

agree with the goals of the law or simply because it is the law, and “organizational incompetence” – firms that are willing to comply, but fail to do so because they are ignorant of the law or lack the required internal controls.³²⁴ Nielsen and Parker’s study of Australian firms arrives at a typology of “social citizens” – firms that want to comply and pursue their own economic and societal interests; “good citizens” – firms that are like the social citizens, but downplay the priority social motivations to comply and agree less with the substantive goals behind the law; and “dissenters” – firms that again look like the first group, but disagree with the goals of the law.³²⁵ Kirchler et al suggest a slippery slope framework with power and trust as two dimensions in explaining enforced and voluntary compliance.³²⁶ Building on the idea of responsive regulation,³²⁷ Braithwaite provides a motivational pyramid to explain the different reactions to regulation and the corresponding strategies.³²⁸

All these existing typologies are elegant, seeking to present a holistic understanding of compliance behaviour. They also vow to be used as descriptors in a

³²⁴ Robert Kagan and John Scholz, ‘The “Criminology of the Corporation” and Regulatory Enforcement Strategies’ in Keith Hawkins and John Thomas (eds) *Enforcing Regulation* (Kluwer-Nijhoff Publishing 1984) 67, 96.

³²⁵ Christine Parker and Vibeke Nielsen, ‘Mixed Motives: Economic, Social, and Normative Motivations in Business Compliance’ (2012) 34 *Law & Policy* 428,462.

³²⁶ Erich Kirchler, Erik Hoelzl and Ingrid Wahl ‘Enforced Versus Voluntary Tax Compliance: The ‘Slippery Slope’ Framework’ (2008) 29 *Journal of Economic Psychology* 211, 225.

³²⁷ Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press 1992).

³²⁸ Valerie Braithwaite, *Defiance in Taxation and Governance: Resisting and Dismissing Authority in a Democracy* (Edward Elgar 2003).

wide range of contexts. But most are based on experiences from liberal democratic countries, usually with a developed economy. When they are applied to China and other authoritarian countries, two inadequacies stand out. One is, as mentioned above, that they often assume a high level of legitimacy of the law and authorities; the other is that they overwhelmingly focus on motivations. Of course many factors can be abstracted into motivations, but in play are many other factors such as size and business environment. These factors may be less conspicuous in a developed economy, but they are more visible in a developing country with nascent rule of law and a low level of public trust. There is thus a need to develop a framework comprehensive enough to cover these countries. Building on existing literature and ethnographic data, this article represents such an effort.

Inspired by these two strands of studies, this chapter examines two variables and their impact on compliance in different settings. One variable is whether structural opportunities to evade regulation are high or low. By structural opportunities, I mean objective arrangements or positions that cannot be altered by the regulated businesses or individuals. The other is whether social norms to comply among the regulated are strong or weak. Social norms refer to the values or morality in which the regulated businesses or individuals believe when making compliance decisions. Considering the two groups of factors, a two-by-two matrix to present four types of compliance decisions was developed (Table 20). As mentioned, both structural opportunities and social norms include numerous factors. To group them into these two possibilities, I hope to provide a comprehensive framework to highlight variations in compliance.

Table 20. A Typology of Compliance

		Structural opportunities to evade	
		High	Low
Social norms to comply	Strong	Strategic compliance	Voluntary compliance
	Weak	Aggressive evasion	Obligated compliance

As will be shown, this framework will be particularly useful in explaining the (non) compliant behaviour of tax compliance among Chinese shoe manufacturers. When the structural opportunities to evade taxes are high and social norms to comply with the law are low, taxpayers are more likely to cheat on taxes. We call this category aggressive evasion. While this group only involves a small amount of taxpayers in most studies based on developed countries, it is the biggest in my case. Conversely, when the structural opportunities to evade are low and social norms to obey the law are high, taxpayers are more likely to pay taxes in accordance with the law. To borrow a term from Kirchler et al, this group is labelled as voluntary compliance.³²⁹ As will be shown, this group is small in my case, while in other studies it may be the biggest. When structural opportunities to evade are high but social norms to comply are strong, taxpayers generally comply with the law, but occasionally they evade it. They evaluate their choices based on “amoral calculation” of gains and losses:³³⁰ to what extent will compliance bring more long-term benefits?

³²⁹ Erich Kirchler, Erik Hoelzl and Ingrid Wahl ‘Enforced Versus Voluntary Tax Compliance: The ‘Slippery Slope’ Framework’ (2008) 29 *Journal of Economic Psychology* 211, 225.

³³⁰ Robert Kagan and John Scholz, ‘The “Criminology of the Corporation” and Regulatory Enforcement Strategies’ in Keith Hawkins and John Thomas (eds) *Enforcing Regulation* (Kluwer-Nijhoff Publishing 1984) 67, 96.

They disobey the law when their business survival requires it. Their decisions are thus instrumental and strategic. Inspired by the term “strategist” used by Gunningham et al,³³¹ we call this group strategic compliance. We shall note, however, that Gunningham et al’s strategies are mainly concerned with the efficiency and effectiveness of environmental measures, while ours focus more on the benefits and losses associated with complying with tax laws. Finally, when structural opportunities to evade are low and social norms to comply are weak, taxpayers are often forced to comply. We call this group “obliged compliance.” They differ from “enforced compliance” because enforced compliance emphasizes the power of the authorities.³³² “Obliged compliance” emphasizes not just the power of the authorities, but also that the businesses do not believe that the laws should be obeyed. They comply only because they have to. They will evade the law whenever there is an opportunity.

Aggressive Evasion

In City Q where I conducted my fieldwork, a large percentage of shoe companies were engaged in aggressive cheating on VAT by deceiving output and input values. Two factors were significant in shaping these aggressive cheaters’ taxpaying decisions: high structural opportunities to evade and weak moral norms to comply. Of

³³¹ Neil Gunningham, Robert Kagan and Dorothy Thornton, *Shades of Green: Business, Regulation, and Environment* (Stanford University Press 2003) 113.

³³² Robert Kagan and John Scholz, ‘The “Criminology of the Corporation” and Regulatory Enforcement Strategies’ in Keith Hawkins and John Thomas (eds) *Enforcing Regulation* (Kluwer-Nijhoff Publishing 1984) 67, 96.

my sample, there were 13 of such cases in City Q. Each of them were small- or medium-sized domestic companies (see Appendix 2, Note 1) supplying either shoe materials or half-finished shoes. There were 15 of such cases in City S.

Bumblebee (Q3), originally a small workshop without registration, was officially established as a shoe manufacturer in 2006. With 2,000 employees in 2016, it reported an annual revenue of 45 million RMB and paid 2 million for VAT and 1 million for other taxes and fees. According to its financial manager, however, its actual revenue was 330 million. With the exception of 45 million that had been recorded in output receipts and its corporate bank account, the rest did not have output receipts and had been handled through individual accounts or cash.

Fashion (Q9), with 20 million in gross income and 200 workers in 2016, had yet to register with the tax authorities, despite doing business since 2009. The owner told us:

90 per cent of our transactions are from Taobao. I also operate a wholesale shop downtown. Customers pay by cash. Other companies are registered because they need to do business with companies which need invoices.

When I conduct business with companies who need tax receipts, I ask my uncle, who runs a shoe manufacturer, to issue a tax invoice for me with a commission (10 per cent of the total price). He then returns to me the money that the buyer paid to his company. But this only occurs once or twice per year... The tax authorities and other government officials never bother us... I

have never heard of anyone reporting us. You know, this is a small, close-knit community. People meet with each other every day. They or their friends and relatives also run shoe businesses without registration. No one will do the stupid thing.

Most enterprises in this group try to keep their operations invisible to the tax authorities. Physically, they have storage rooms unknown to the tax authorities. This is easier for the material traders, who have no machines and hire fewer employees. As for the paperwork, most companies keep at least two accounting books. One is provided to the tax authorities and based on legal tax receipts, but with incomplete and unauthentic records (the overt book). The other has the complete and authentic sales and activities (the covert book).³³³ The enterprises have come up with many strategies to escape audit. The financial manager of Bumblebee (Q3) provided one:

We never kept the covert book in the office. There was a separate room at the owner's home. The accountants kept the covert book and put related documents in that room. The tax officials could only find the overt book.

The financial manager of Dragon (Q4) provided another strategy:

We keep the overt book on the computer but the covert book on a USB key drive. The USB was always with the accountants. When they (tax officials)

³³³ Some taxpayers kept three accounting books. The third one was shown to local banks. In this book, the revenues would be exaggerated in order to get more loans from banks.

check our computer, everything is the same as in the reported statements.

We are always prepared. How can they find it? (chuckling)

Occasionally these practices were detected, however. Bumblebee was found to have underreported an enormous amount of transactions in 2016. According to the law, apart from paying the backed taxes along with interest, they should have been fined 1-5 times the amount of taxes they had evaded,³³⁴ and should have been charged an overdue fee of 0.05 per cent per day.³³⁵ Given the amount evaded, the normal fine would have been at least 0.7 million RMB.³³⁶ However, the owner of Bumblebee had mobilized its political and social resources to minimize the sanctions. The financial manager (Q3) told us:

In the end, we paid thousands of RMB, a little bit... You know, every company more or less has relations with the government. Everything can be settled as long as you can find *guanxi* (social connections). If your *guanxi* is rock strong, you pay less; if your *guanxi* is weak, you pay more.

³³⁴ Article 64, 65, and 68 of the Law of the PRC on the Administration of Tax Collection, amended on 24 April 2015.

³³⁵ Article 32 of the Law of the PRC on the Administration of Tax Collection, amended on 24 April 2015.

³³⁶ The output value was around 2.60 million (according to the financial manager). Bumblebee had paid 0.10 million for VAT ($2.60 \times 17\% - 2 \times 17\%$). Now it was not allowed to deduct input value of 2 million, and it had to pay VAT 0.44 million ($2.60 \times 17\% - 0 \times 17\%$). The owed taxes with interest was around 0.34 million ($0.44 - 0.10$, interest was omitted since it was miniscule. According to the bank interest rate in 2016, the interest = $(0.44 - 0.1) \times 1\% / 12 \times 3 \text{ months} = 0.00085$ million), the fine was 0.34 million, and the overdue fee was 0.02 million ($0.34 \times 90 \text{ days} \times 0.05\%$). In total, Bumblebee had to pay 0.70 million.

The intensive market competition and the thin profit margins for these low-end manufacturers compound their situation. The widespread tax evasion imposes pressure on the supply chain. There were two prices on the market: a higher price with tax invoices and a lower price without tax invoices. The gap was around 4-5 per cent. In order to reduce costs, most taxpayers chose the lower price. In order to improve competitiveness, taxpayers avoided issuing output tax invoices in order to offer lower prices. This has become a vicious circle.

If invisibility, thin profits, and weak enforcement are structural opportunities for underreporting, weak social norms to pay taxes are the other reason for tax evasion. The most common view on tax evasion among companies with which I conducted fieldwork was ‘everyone is evading taxes.’ Paying taxes honestly was perceived as foolish. Similar statements included, ‘Have you heard of anyone who is not evading taxes?’ ‘99 per cent of businesses in City Q are evading taxes (Lion Q10),’ ‘Large companies also evade taxes, let alone us (Deer Q2),’ and ‘Am I a fool who would pay all the taxes? Everyone is evading (Youth Q13).’ The aggressive evaders perceived the least pressure from the local community since most similar companies were also evading taxes. The norm of tax evasion was dominant.

The legitimacy of the tax law seemed low. Taxpayers rarely felt obligated to pay any taxes. They complained that the tax burden was too high to bear. If they paid their taxes honestly, they might not be able to survive. However, businesses also doubted

or remained ignorant about how the government spent their tax money. In other words, they would receive the least benefit by paying their taxes.

I prefer to donate money to the village committee instead of paying taxes to the government. Though some of them (managers of the village committee) might also embezzle contributions, they at least do something meaningful, for example, constructing roads and schools... You would get a good reputation in the community as well (by donating money to the village committee). Paying taxes is useless. You never get them back and you have no way to know where they are spent (Martin Q11).

Once I attended a National People's Congress (NPC) at the County Government that discussed how the money could be used to construct leisure facilities for local residents. The mayor also sat there. The other two NPC members dare not to give their opinions. I was the first to suggest that we needed more than 10 million RMB to build a sports centre. The mayor said they could only afford two million. I became silent. Two million can only cover a large stone pillar! (Lion Q10)

The way that tax authorities enforced the tax law generated distrust among the taxpayers. Their relationship is more antagonistic than synergistic, very similar to

“cops and robbers”.³³⁷ I heard several similar statements on tax authorities in City Q, for example, ‘they bear a grudge if we do not listen to them or argue with them (Bumblebee Q3),’ ‘We are lambs to be slaughtered (Martin Q11),’ and ‘They seem like a poorly fed cow (Lion Q10).’ They regarded “audits” and law enforcement as “disturbing” or a sign of asking for a bribe. The financial manager of Dragon (Q4) told us how they had given gifts and money to tax officials:

Dare you not treat them when they call to investigate some problems? Dare you not worship the Tudigong (the “Lord of Land,” a metaphor referring to tax officials)? Do you know how they receive gifts and money now? They receive coupons. Sometimes, we put prepaid shopping cards inside several coupons. Once, we packed ten bottles of tea, but with money in one or two of the bottles. When we handed them the tea, we emphasized, “please open them by yourself.” They got the point.

Table 21 shows that four companies in this group, on average, underreported 78.5 per cent of their taxes in 2016. The estimated VAT gap was 87.56 per cent. Dragon and Youth reported more annual revenue because they had conducted portions of their business with foreign clients who required tax invoices.

³³⁷ Ingrid Wahl, Barbara Kastlunger and Erich Kirchler, ‘Trust in Authorities and Power to Enforce Tax Compliance: An Empirical Analysis of the Slippery Slope Framework’ (2010)32 *Law & Policy* 383,406.

Table 21. The Estimated VAT Gap of 4 Shoe Manufacturers in 2016 (Millions, RMB)

Case	Reported/Actual output	Reported/Actual input	Expected output	Expected input	Paid/Expected VAT	Reported/Expected tax burden ratio	VAT gap
Bumblebee	45/330	33.8/165	342.1	170.6	1.9/29.2	4.25%/8.52%	93.44%
Dragon	13/40	9.8/25.6	41.1	26.3	0.6/2.5	4.25%/6.15%	78.15%
Lion	2/18	1.5/9.9	18.7	10.3	0.1/1.4	4.25%/7.67%	94.06%
Youth	23/80	17.3/44	82.4	45.1	1/6.3	4.25%/7.69%	84.58%
Average							87.56%

Sources: authors' fieldwork investigations.

Obligated Compliance

When the structural opportunities to evade decrease, businesses are forced to pay their taxes. Due to the weak social norms to comply, however, businesses still try to evade as much tax as possible. These two factors (structural opportunities and norms) resulted in obligated compliance. In my sample, 19 cases, all shoe manufacturers, belonged to this category in City Q. The group consisted of one large company, eleven medium-sized companies, and seven small companies. One company was focused on the domestic market (Laden), while the rest were focused on overseas markets. In City S, there were 15 such cases.

Compared with aggressive evaders, businesses of this type enjoy fewer structural opportunities to evade. Laden (Q29) is a big outdoor sports shoe manufacturer and supplier. With two brand names and 1,200 employees, it has more than 3,000 retail stores around the country. In 2016, Laden's annual revenue reached 500 million RMB. It paid 27.5 million in taxes, 5.5 per cent of its annual revenue. The amount of VAT was around 20 million (72.7 per cent of the total tax). Normally operating in high-end shopping malls, its chain stores applied a formal and integrated system to

settle transactions, in which tax invoices were automatically issued. The system left little room for Laden to conceal the transactions.

Small- and medium-sized companies also had fewer opportunities to evade when they conducted business in the highly regulated overseas markets. Step (Q20), a manufacturer specializing in shoes used in harsh environments, had built strong business relations with Japanese wholesalers and retailers. In 2016, it hired 160 employees and its annual revenue hit 50 million RMB. Since the company had not been licensed to export, it had cooperated with a local trade company. The company needed lawful and accurate output tax receipts for customs clearance. While Step could have asked a third company to issue fake output receipts, it chose not to. Doing so would have required Step to pay 10 per cent in commission. Additionally, Step had also wanted to use their own name to build long-term relationships with Japanese companies. For similar reasons, Step and 16 other companies had issued output tax invoices honestly.

Companies in this group were more visible to tax officials. The risk-based regulatory system, like the tax burden rate and the variation in annual revenues, was effective in overseeing them. Once their VAT burden ratios had not met the requirement, or the annual revenue had drastically changed, the risk system would alert tax officials. Over the previous three years, 8 of the 19 companies (42.11 per cent) had been audited and sanctioned, and 10 (52.63 per cent) had been required to

explain the sources of their input tax invoices. The audit and sanction rate had been much higher than that of the aggressive evaders (2 out of 13, 15.39 per cent).

Despite being more visible and highly regulated, companies in this group held weak social norms to obey tax laws. Faced with fierce competition and rampant violations of their trademarks, they found the tax system unreasonable. In the words of Friedman,³³⁸ the law was not worthy of being obeyed.

The implementation of the tax burden ratio, one of the most important VAT regulatory strategies, only reinforced a perception of the unfairness and unreasonableness of the VAT system. One reason for this may be that the VAT burden ratio ignores the commercial risks of the real world. As the financial manager of Simba (Q17) said:

VAT is very unfair: it always increases, it never decreases. We have to always keep our VAT burden ratio at around 4.25per cent. The tax authorities think that every transaction has an added value. But sometimes we can't increase the value. At the beginning of this year, the price of raw materials was stable. From March to June, the price doubled. Eventually, we were losing 2.5 per pair of shoes... Tax officials did not trust our explanation. They asked, 'how come your business is bad, while others were

³³⁸ Friedman Lawrence, *The Legal System: A Social Science Perspective* (Russell Sage Foundation 1975) 69.

doing good...’ You know, not everyone can grow as high as Yao Ming (the NBA basketball player), right? It is really unreasonable...

Because of the weak social norms to comply, taxpayers sought all possible opportunities to evade the VAT. The most common practice was increasing the amount of input to get more deductions. That is, they would buy raw materials at a low price from one party, and then buy illegal input tax invoices at a higher price from a third party. As a result, businesses kept the tax burden ratio at around 4.25 per cent, as required by tax authorities. Step’s accountant (Q20) explained to us:

We normally keep our ratio stable. If your ratio is 2 per cent, the tax authorities’ risk rating system might label you as too low and you will be required to explain. If your ratio is 4.5 per cent, the tax authorities will ask you to explain only if it decreases. We normally keep our VAT burden ratio around 4.25 per cent to avoid unnecessary trouble.

As Table 22 shows, the estimated VAT gap of 11 shoe manufacturers in this group averaged 45.72 per cent in 2016, lower than the 87.64 per cent for the aggressive cheaters.

Table 22. The Estimated VAT Gap of 11 Shoe Manufacturers in 2016 (Millions, RMB)

Case	Reported/Actual output	Reported/Actual input	Expected output	Expected input	Paid/Expected VAT	Reported/Expected tax burden ratio	VAT gap
Step	40.0	30/22.8	23.8	23.8	1.7/3	4.25%/7.31%	44.23%
New Nam	30.0	22.5/13.5	14.1	14.1	1.3/2.9	4.25%/9.35%	56.41%
Calais	300.0	225/168	175.1	175.1	12.8/23.4	4.25%/7.48%	45.50%
Simba	50.0	37.5/25	26.1	26.1	2.1/4.4	4.25%/8.50%	52.05%
Anput	120.0	90/66	68.8	68.8	5.1/9.6	4.25%/7.65%	46.71%
Fortune	150.0	112.5/82.5	86.0	86.0	6.4/12	4.25%/7.65%	46.71%
Central	45.0	33.75/25.65	26.7	26.7	1.9/3.4	4.25%/7.31%	44.22%
Tripod	20.0	15/11	11.5	11.5	0.9/1.6	4.25%/7.65%	46.71%
Laden	500.0	375/325	338.8	338.8	21.3/31	4.25%/5.95%	31.48%
Golden	250.0	187.5/155	161.6	161.6	10.6/16.8	4.25%/6.46%	36.90%
Leather	38.0	28.5/19	19.8	19.8	1.6/3.4	4.25%/8.50%	52.05%
Average							45.72%

Sources: authors' fieldwork investigations.

Strategic Compliance

Few companies in the shoe industry in City Q were pressured to pay taxes by social norms. But there was one exception, a company that had aspired to become listed on the stock market. The motivation to comply with the law in this case was largely instrumental and strategic. A poor record in tax compliance may taint a company's reputation, and eventually reduce its chances of getting listed. Nonetheless, when more structural opportunities to evade exist, a company will occasionally disobey the laws, especially when business is not good and it is desperate for more profit in order to survive.

Norkey (Q33) is a medium-sized company specializing in producing and selling shoe soles for the domestic market. It had won the "customers satisfied products" award issued by the provincial government. In 2014, Norkey's actual annual revenue

was about 40 million RMB. However, it had only reported 15 million to local tax authorities, paying about 0.8 million in taxes (0.63 million for the VAT). The taxes paid were more or less in line with other medium-sized materials manufacturers.

What differentiated Norkey from others was that its owner and his wife had decided to go public, which could generate more funding and improve their brands. Also, the owner had tried to gain popularity in the local community, and was thus likely to be selected as a member of the NPC.

The couple was determined. In 2015, their reported revenue was 42 million RMB—an increase of 64.29 per cent (only 15 million) from 2014. The annual amount of tax they were paying had reached 2.3 million. Norkey even over reported income by deducting less costs and fees than it had been required to.

To control financial risks including illegal operations and tax evasions, Norkey set up a series of regulations and enhanced the norms to comply. They started to report actual revenue to the tax authorities since any suspicion of tax evasion could increase the risks of not getting approved for listing. Once obeying the law becomes consistent with the long-term goals of the company, the norms to operate lawfully are also cultivated. The owner (Q33A) said:

If one wants to go public, they need to report annual revenue honestly. The higher revenue the company has, the more likely it gets approved...If you want to become a good company, operating in accordance with the law is the

only way to go...Being listed can also generate substantial tax subsidies from the government...³³⁹ No pain, no gain.

Nonetheless, “no pain, no gain” suggests that the owner’s ultimate goal is the maximization of profit—and he regarded law compliance as “pain.” This indicates he did not really believe in the value of the law. He chose to obey because compliance would bring longer-term and higher profits. His choice is thus instrumental and strategic. Both his political goal to become an NPC member and his modified strategy when his company was struggling to survive in a turbulent business environment only reinforced this point.

In June 2016, when the company’s profit had shrunk by 50 per cent, it decided to deceive inputs and outputs for three months until its profit had recovered by the end of the year. As a materials manufacturer, Norkey enjoyed plenty of structural opportunities to evade, since most of its trading partners were using fabricated invoices. Some of its trading partners even refused to accept official tax receipts. Indeed, the owner’s perception of the law was not unique among the 40 companies waiting for listing every year in City Q. According to Norkey’s financial manager, companies failing to get listed soon resumed their prior tax evasion strategies.

³³⁹ In 2012, the local government enacted the subsidy policies for the listed companies.

Voluntary Compliance

Companies with few opportunities to evade and strong social norms to comply were more likely to pay taxes honestly. Two listed companies, Pace and Shaw, provide examples.

Established in 1999 and listed in 2008, Pace (Q34) is one of the leading sportswear companies in China. It is engaged in designing, development, manufacturing and marketing of sporting goods for the domestic market. With 6,800 stores dotting all 31 Chinese provinces, Pace's revenue reached 5,300 million RMB in 2015. It paid 290 million (5.5 per of revenue) for VAT and other taxes.³⁴⁰

To tax officials, companies in this group were highly visible. Listed companies were regulated by the tax authorities and other government branches (e.g., the Stock Supervisory Committee). They have to publicize annual financial reports prepared by an independent third party, usually an accounting firm. All information can be cross-checked. Moreover, accountants or disgruntled financial staff who are aware of any potential unlawful company practices might report them to the tax authorities. Of course, this occurred in small- and medium-sized companies as well. However, the consequences are more severe for a listed company that values its reputation. The financial manager of Pace (Q34) explained:

The requirements of the VAT law, for example, keeping and issuing tax invoices, are consistent with our everyday practices. We sold our shoes in

³⁴⁰ The data was collected from the Company's Annual Financial Report 2016.

well-known shopping malls. We earned higher added values than small-medium companies. We are concerned about controlling costs and making profits through lawful ways instead of tax evasion because we can transfer the taxes into the price. We are more concerned about improving our competitiveness by new designs, advanced technologies, and catering to clients' tastes.

Though Shaw's revenues slid after being listed, it had not changed the practice of tax compliance. Its financial manager (Q35) told us:

Before being listed, we removed unlawful suppliers and customers from our list of trading partners. After being listed, though we performed poorly, we cared about our reputation on the stock market. We knew that any tax evasion might be catastrophic for the company. Luckily, we have been acquired by a powerful third party. Now we operate lawfully.

Since news of tax evasions could ruin the image of brand names in which they have invested heavily to build, paying taxes according to the law has become their norm. A violation of the law can destroy a listed company. Compared with other companies, listed companies are more willing to self-regulate without external pressure. With authentic and complete paperwork, they can also build mutual trust with the tax authorities, which rarely audit them. Furthermore, large companies lose the trust of local governments and tax authorities if tax evasion is detected. Additionally, honors and awards, such as the "Top 100 companies in City Q," which

are significant for the company, will be recalled. Larger companies like to pay taxes honestly so that they ‘have strong bargaining power to penetrate formal representative institutions, which they in turn use to press for more responsive government.’³⁴¹ They also like to cooperate with tax authorities to survive through periods of low revenue. The financial manager of Pace (Q34) said:

You know, tax authorities should collect the targeted amount of revenue, which is required by the upper-level tax authority. Sometimes, they cannot meet the annual target. The tax officials called me and asked for help before December. We were willing to pay more taxes to help them.

Conclusions

This chapter has demonstrated the varied tax paying practices in southeast China. Taxpaying decisions in China’s shoe industry are thus shaped by numerous factors: the size of the company, their position in the production chain of the industry, the trust between the companies and the tax authorities, the behavior patterns of their trading partners, peer pressure, and compliance with other social norms. Grouping these factors into structural opportunities or social norms, the typology illustrates their interactions and consequences. Weak social norms in taxpaying practices explain why tax evasion is rampant. The low level of legitimacy of law and its corrupt enforcement explain why aggressive cheating is widespread. The relationship between the tax

³⁴¹ Changdong Zhang, *Good governance through Taxation: Business Politics in Authoritarian China* (DPhil thesis, University of Washington 2011) i.

authorities and the taxpayers is more antagonistic than synergistic: taxpayers feel persecuted by the authorities and feel it their right to hide.³⁴² Many taxpayers are thus aggressive evaders and only a tiny percentage of them comply voluntarily. In between are two groups: strategic compliance and obliged compliance. Neither respects the law or the authorities, and little choice is left for them. With the exception of the smallest category, voluntary compliance, Chinese taxpayers try to maximize their expected utility, and only comply when forced to do so. They weigh probabilities of detection and the outcomes, and evade whenever possible.

³⁴² Valerie Braithwaite, *Defiance in Taxation and Governance: Resisting and Dismissing Authority in a Democracy* (Edward Elgar 2003).

Chapter Seven. Beyond Tax Compliance in China

To explain the variations in taxpaying practices in southeast China, this dissertation has suggested two dimensions to explain compliance more generally. One is structural opportunities to evade tax. The other is social norms that encourage compliance. These two dimensions, working together, generate four ideal types of taxpaying behaviour: aggressive evasion, strategic compliance, obliged compliance, and voluntary compliance.

This study also examines the role of two dimensions separately. On one hand, the divergence of the structural opportunity to evade tax results from the dynamic between social and institutional opportunities. A group of taxpayers enjoy two strokes of luck because their social and institutional opportunities to evade tax are both high, while remaining taxpayers suffer as their social and institutional opportunities to evade tax are low. On the other hand, procedural norms appear to play only a small role in enhancing tax compliance in current China; instead, substantive norms consisting of individual, vertical, horizontal, and exchange norms are important in understanding the unwillingness or willingness of Chinese people to pay taxes.

While it is unrealistic to have a single theory or framework to explain all situations of regulation and compliance across the world, this study's framework does incorporate the major factors discussed in the existing literature and provides a comprehensive alternative to understanding the complexity of compliance. A useful theoretical framework has to survive application beyond its original context. The

typology of this framework is not limited to this case study; it can be broadly applied to help understand compliance in other jurisdictions and regulatory fields. As a conceptual tool, my framework can also organize previous research in regard to the dimensions of structural opportunities and social norms. In this final chapter, I apply the typology to organizing extant tax compliance research, to explain compliance in other regulatory contexts, and to propose a two-pronged regulatory strategy.

Applying the Typology to Previous Tax Compliance Research

Most previous studies on tax administration have focused on the specific factors of either social norms or structural opportunities, depending on the context of the research.³⁴³ This is understandable because, in these regulatory fields, the impact of different factors varies and the impacts of some factors are more pronounced than others. McGraw and Scholz argue for civic virtue, an obvious element of social norms, in the boosting of tax compliance.³⁴⁴ Braithwaite argues for a new perspective on tax compliance; the thrust of her argument is to boost taxpayers' commitment to

³⁴³ Kathleen McGraw and John Scholz, 'Appeals to Civic Virtue Versus Attention to Self-Interest: Effects on Tax Compliance' (1991) 25 *Law & Society Review* 471, 498; Joseph Rees, 'Development of Communitarian Regulation in the Chemical Industry' (1997) 19 *Law & Policy* 477, 528; Doreen McBarnet, Aurora Voiculescu, and Tom Campbell (eds), *The New Corporate Accountability: Corporate Social Responsibility and the Law* (Cambridge University Press 2009) .

³⁴⁴ Kathleen McGraw and John Scholz, 'Appeals to Civic Virtue Versus Attention to Self-Interest: Effects on Tax Compliance' (1991) 25 *Law & Society Review* 471, 498.

paying tax with or without supervision from tax authorities.³⁴⁵ One may interpret this commitment as being aligned with culture, identity, or psychology, but it nonetheless falls into the category of social norms. The emphasis on taxpayers' commitment in liberal democracies also indicates the less urgent need for the stringent implementation of tax laws here. This point is echoed by Kirchler et al.,³⁴⁶ who argue for the importance of building trust in authorities. Trust, as defined in their study, can consist of either structural opportunities or social norms.³⁴⁷ Elements of apparent structural opportunities, such as audit probabilities and fines, can be converted into trust because 'the subjectively perceived probabilities and its interpretation', which are 'mediated via psychological variables', are more important than the 'objective audit probability'.³⁴⁸ In another study, Scholz and Pinney examine how duty and fear affect tax compliance.³⁴⁹ Duty, as they define it, is the desire to conform to internalized norms or beliefs about right and wrong. Similar to the fear of the consequences of acquiring a bad reputation, duty stems mainly from social norms.

³⁴⁵ Valerie Braithwaite, *Defiance in Taxation and Governance: Resisting and Dismissing Authority in a Democracy* (Edward Elgar 2003).

³⁴⁶ Erich Kirchler and Ingrid Wahl, 'Enforced versus Voluntary Tax Compliance: The "Slippery Slope" Framework' (2008) 29 *Journal of Economic Psychology* 220.

³⁴⁷ *ibid* 210-225.

³⁴⁸ *ibid* 215.

³⁴⁹ John Scholz and Neil Pinney 'Duty, Fear, and Tax Compliance: The Heuristic Basis of Citizenship Behavior' (1995) 39 *American Journal of Political Science* 490, 512.

However, the fear of punishment and detection is, by and large, a structural element.³⁵⁰

Extending the Typology to Other Regulatory Contexts

The typology can be applied beyond the field of tax compliance, to other regulatory areas. It fits well with Kagan and Scholz's classic typology consisting of amoral calculators, political citizens, and incompetent firms. Due to both the lack of social norms with which to comply and legitimacy in law, aggressive evasion, obliged compliance, and strategic compliance are all amoral calculators.³⁵¹ Only voluntary compliance, which a tiny proportion of taxpayers practice in my case, may be considered as aligning with the concept of the political citizen. Similarly, in Thornton et al.'s study on environmental regulation in the pulp and trucking industries, the impact of structural opportunities and social norms is obvious.³⁵² They argue that size, an element of structural opportunities, makes a difference, because large companies are more visible and have higher profit margins than small companies. Visibility, as

³⁵⁰ See Robert Kagan, Neil Gunningham, and Dorothy Thornton, 'Fear, Duty, and Regulatory Compliance: Lessons from Three Research Projects' in Christine Parker and Vibeke Nielsen (eds), *Explaining Compliance: Business responses to regulation* (Edward Elgar Publishing 2011) 37.

³⁵¹ Robert Kagan and John Scholz, 'The "Criminology of the Corporation" and Regulatory Enforcement Strategies' in Keith Hawkins and John Thomas (eds), *Enforcing Regulation* (Kluwer-Nijhoff Publishing 1984) 67.

³⁵² Dorothy Thornton, Robert Kagan and Neil Gunningham, 'When Social Norms and Pressures are Not Enough: Environmental Performance in the Trucking Industry' (2009) 43 *Law & Society Review* 405, 436.

Kagan argues, is crucial.³⁵³ On the contrary, small businesses have “mobile pollution sources” and thus more structural opportunities to evade tax. The importance of size in the understanding of compliance is echoed by Braithwaite and Genn, who found that voluntary compliance only occurs among the largest and the most hazardous companies, those most visible to authorities, and local communities.³⁵⁴ For small trucking businesses, Thornton et al. argue that, because social norms are not enough, strong direct regulatory pressures are needed to bring about significant improvements in environmental performance.³⁵⁵ The typology is also consistent with May’s classification of compliance motivations.³⁵⁶ He divides compliance motivations into affirmative and negative bases: ‘Affirmative motivations emanate from good intentions and a sense of obligation to comply. Negative motivations arise from fears of the consequences of being found in violation of regulatory requirements’.³⁵⁷ Social

³⁵³ Robert Kagan, ‘On the Visibility of Income Tax Law Violations’ in Roth Jefferey and John Scholz (eds), *Taxpayer Compliance Volume 2: Social Science Perspective* (University of Pennsylvania Press 1986) 76, 125.

³⁵⁴ Valerie Braithwaite, *Defiance in Taxation and Governance: Resisting and Dismissing Authority in a Democracy* (Edward Elgar 2003); Hazel Genn, ‘Business Responses to the Regulation of Health and Safety in England’ (1993) 15 *Law & Policy* 219, 233.

³⁵⁵ Dorothy Thornton, Robert Kagan, and Neil Gunningham, ‘When Social Norms and Pressures are Not Enough: Environmental Performance in the Trucking Industry’ (2009) 43 *Law & Society Review* 405, 436.

³⁵⁶ Peter May, ‘Compliance Motivations: Affirmative and Negative Bases’ (2004) 38 *Law & Society Review* 41, 68.

³⁵⁷ *ibid* 42.

pressure or a duty to comply (“affirmative motivations”, in May’s words), is the core element of social norms. A fear of violations being detected and subsequent punishments, or negative motivation, can be interpreted as structural opportunities. The difference between May’s classifications and my typology is that social norms and structural opportunities cover more factors. Overall, we see that the interactions between structural opportunities and social norms determine the level of compliance.

Due to the numerous factors involved here, as well as the complex interactions of these factors, Parker and Nielsen avoid a general framework, and only suggest using a holistic, plural model of business compliance.³⁵⁸ They suggest four main sets of independent variables: motives, organizational capacities and characteristics, regulation and enforcement, and the social and economic environment. This model is consistent with my typology. The factors can be grouped as either structural opportunities or social norms. Most factors in organizational capacities and characteristics, regulation and enforcement, and the economic environment can be classified as structural opportunities. Most elements in the social environment may be considered social norms. Motives may contain elements of both structural opportunities and social norms. While economic and material motives may come from structural reasons, normative motives are mainly derived from social norms.

³⁵⁸ Christine Parker and Vibeke Nielsen, ‘Introduction’ in Christine Parker and Vibeke Nielsen (eds), *Explaining Compliance: Business Responses to Regulation* (Edward Elgar Publishing 2011) 5.

The typology also promises an alternative, if not better, understanding of regulatory practices. For example, in Gezelius and Hauck's study on the compliance motivations of fishing communities in Norway, Canada, and South Africa, they argue that deterrence, moral support for the law's content, and legislator authority are the key factors in shaping compliance.³⁵⁹ These three factors, however, fit with the typology. They define the motivation of deterrence as 'the outcome of individuals' utilitarian, socially detached rationality'.³⁶⁰ This is similar to "enforcement" in my study of taxpaying in China, and thus is a factor of structural opportunity. In contrast to this, the motivations for moral support of the law's content and legislator authority can be considered as social norms in the typology, since they are 'shared perceptions, values and behavioural norms'.

The varied practices of compliance across different fisheries are the result of the interactions of structural opportunities and social norms. South African small-scale fisheries have low levels of compliance. Fishermen even resist state regulations through direct conflict with law enforcement authorities.³⁶¹ In this instance, there had been many structural opportunities to avoid fishing regulations because of inadequate

³⁵⁹ Stig Gezelius and Maria Hauck, 'Toward a Theory of Compliance in State, Regulated Livelihoods: A Comparative Study of Compliance Motivations in Developed and Developing World Fisheries' (2011) 45 *Law & Society Review* 435, 470.

³⁶⁰ *ibid* 436.

³⁶¹ Stig Gezelius and Maria Hauck, 'Toward a Theory of Compliance in State, Regulated Livelihoods: A Comparative Study of Compliance Motivations in Developed and Developing World Fisheries' (2011) 45 *Law & Society Review* 435, 470.

patrolling and extensive corruption. Additionally, social norms to comply were perceived as weak. Taken together, the two variables resulted in aggressive violations of fishing regulations in South Africa.

The situation in Newfoundland, Canada, can be explained by fewer structural opportunities to violate and weaker social norms to comply with tax laws. The Newfoundland authorities enforce the ban on overfishing strictly, regardless of whether or not subsistence or commercial fishing were prosecuted and fined through the court system.³⁶² The moral support for subsistence fishing regulations, however, was perceived as low. That is why, despite vigorous formal enforcement, compliance in this community remained at ‘moderate levels’.³⁶³ In a similar vein, Norwegian inshore vessels witness strong social norms to comply with, but more opportunities to violate tax laws. The two situations are similar to obliged compliance and strategic compliance in the typology. The offshore vessels in Norway and the commercial fishing regulations in Canada are examples of strong social norms to comply with and fewer structural opportunities to evade tax. In my terms, this is a situation of voluntary compliance.

³⁶² Stig Gezelius, ‘Three Paths from Law Enforcement to Compliance: Cases from the Fisheries’ (2007) 66 *Human Organization* 414, 425; Stig Gezelius and Maria Hauck, ‘Toward a Theory of Compliance in State, Regulated Livelihoods: A Comparative Study of Compliance Motivations in Developed and Developing World Fisheries’ (2011) 45 *Law & Society Review* 435, 470.

³⁶³ Stig Gezelius, ‘Three Paths from Law Enforcement to Compliance: Cases from the Fisheries’ (2007) 66 *Human Organization* 414, 425.

Gezelius and Hauck draw a difference between developed and developing countries.³⁶⁴ This is important for their theory because, in different types of countries, governable preconditions for compliance differ. As far as the typology is concerned, we only need to differentiate between the impact of different factors along the dimensions of social norms and structural opportunities.

The second example is the environmental regulation of the pulp and the trucking industry. Gunningham et al.,³⁶⁵ Thornton et al.,³⁶⁶ and Kagan et al. addressed the way in which businesses' compliance decisions were shaped by three "licenses": legal, social, and economic.³⁶⁷ The firm's legal license refers to laws, regulations, and permit conditions. The economic license leads to the firm's obligations to meet the financial expectations of investors and creditors. The social license pressures stem from neighbours, employees, community groups, and other elements of civil

³⁶⁴ Stig Gezelius and Maria Hauck, 'Toward a Theory of Compliance in State, Regulated Livelihoods: A Comparative Study of Compliance Motivations in Developed and Developing World Fisheries' (2011) 45 *Law & Society Review* 435, 470.

³⁶⁵ Neil Gunningham, Robert Kagan and Dorothy Thornton, *Shades of Green: Business, Regulation, and Environment* (Stanford University Press 2003); Neil Gunningham, Robert Kagan, and Dorothy Thornton, 'Social License and Environmental Protection: Why Businesses Go Beyond Compliance' (2004) 29 *Law and Society Inquiry* 307, 341.

³⁶⁶ Dorothy Thornton, Robert Kagan, and Neil Gunningham, 'When Social Norms and Pressures are Not Enough: Environmental Performance in the Trucking Industry' (2009) 43 *Law & Society Review* 405, 436.

³⁶⁷ Robert Kagan, Neil Gunningham, and Dorothy Thornton, 'Fear, Duty, and Regulatory Compliance: Lessons from Three Research Projects' in Christine Parker and Vibeke Nielsen (eds), *Explaining Compliance: Business Responses to Regulation* (Edward Elgar Publishing 2011) 37, 58.

society.³⁶⁸ As Gunningham et al. addressed, reputation capital ‘made future profit: development approvals, preferred access to prospective areas and products, the ear of government, the trust of regulators, the tolerance of local communities, and the least risk of being targeted by ENGOS’.³⁶⁹ In their opinion, economic license and social license interact. When compliance with regulations prompts economic interest, businesses have stronger incentives to comply with paying tax, but when there is conflict between economic interest and social pressures, businesses have weaker incentives to comply.

Based on the aforementioned studies, decision-making related to compliance can be categorized into four types. Large companies are more likely to engage in beyond-compliance behaviour. As Thornton et al. observed, ‘large firms tend to respond more positively to environmental regulation than small firms—they are more visible to, and more closely scrutinized by, regulators, consumers, and advocacy groups. They are more concerned about building and protecting social and political reputation’.³⁷⁰ WA4

³⁶⁸ Robert Kagan, Neil Gunningham, and Dorothy Thornton, ‘Fear, Duty, and Regulatory Compliance: Lessons from Three Research Projects’ in Christine Parker and Vibeke Nielsen (eds), *Explaining Compliance: Business Responses to Regulation* (Edward Elgar Publishing 2011) 37, 58.

³⁶⁹ Neil Gunningham, Robert Kagan, and Dorothy Thornton, ‘Social License and Environmental Protection: Why Businesses Go Beyond Compliance’ (2004) 29 *Law and Society Inquiry* 307, 341.

³⁷⁰ Dorothy Thornton, Robert Kagan, and Neil Gunningham, ‘When Social Norms and Pressures are Not Enough: Environmental Performance in the Trucking Industry’ (2009) 43 *Law & Society Review* 408.

and BC2 in the pulp mill study and Tulane and Police in the truck study are examples of beyond compliance³⁷¹

Companies with low levels of visibility and weak social norms related to compliance have the lowest levels environmental compliance. According to the trucking study, five out of seven (71.43 per cent) small trucking companies fail to comply with regulations.³⁷²

Companies, though they had more opportunities to violate tax laws, performed moderately well when they were subject to supply chain pressure or local community pressure. BC4 in the pulp mill study, part of a moderately sized forest product corporation employing 330 people, said this was due to the way in which it, 'took its responsibilities seriously and sought to maintain compliance even when there were opportunities for avoidance'.³⁷³ Due to underdeveloped audit programs, a lack of environmental personals, and development priorities, however, the company's compliance approaches were limited.³⁷⁴ AUS, which was hard to categorize within

³⁷¹ Neil Gunningham, Robert Kagan and Dorothy Thornton, *Shades of Green: Business, Regulation, and Environment* (Stanford University Press 2003) 110-122.

³⁷² Dorothy Thornton, Robert Kagan, and Neil Gunningham, 'When Social Norms and Pressures are Not Enough: Environmental Performance in the Trucking Industry' (2009) 43 *Law & Society Review* 405, 436.

³⁷³ Neil Gunningham, Robert Kagan and Dorothy Thornton, *Shades of Green: Business, Regulation, and Environment* (Stanford University Press 2003) 110.

³⁷⁴ *ibid* 108, 110.

Gunningham et al.'s typology, meets the characteristics of this group in my typology.³⁷⁵

Despite tighter legal control, some large companies might not perform well, due to weak social norms. For example, 'where there is a single major employer on which the local community depends heavily, not just for jobs but also for its broader economic well-being, criticism tends to be extremely muted'.³⁷⁶ In the pulp mill study, WA2, part of one of the world's largest paper companies and located in a small company town, was subject to strict government inspections but demonstrated poor economic performance and few social pressures. Its environmental performance was well below average.³⁷⁷ BC1, which was difficult to categorize in Gunningham et al.'s typology, fits well in this group.

In short, some of the major theories discussed in previous research on compliance would benefit from a consideration of my typology and the interaction of social norms and structural opportunities. While many existing theories narrow their applications, so as to focus on specific factors of their target areas, my typology can be more broadly applied.

³⁷⁵ Neil Gunningham, Robert Kagan and Dorothy Thornton, *Shades of Green: Business, Regulation, and Environment* (Stanford University Press 2003) 123, 126.

³⁷⁶ Neil Gunningham, Robert Kagan and Dorothy Thornton, 'Social License and Environmental Protection: Why Businesses Go Beyond Compliance' (2004) 29 *Law and Society Inquiry* 307, 341.

³⁷⁷ Neil Gunningham, Robert Kagan and Dorothy Thornton, *Shades of Green: Business, Regulation, and Environment* (Stanford University Press 2003) 103, 107.

A Two-Pronged Regulatory Strategy

What are the regulatory implications of my compliance typology and findings? Can the available regulatory strategies be used to reduce tax evasions in China? I argue that existing regulatory strategies cannot fit well in my compliance typology (Table 23). I argue that only when structural opportunities and social norms are improved together can the state obtain desirable levels of compliance. I call this a two-pronged regulatory strategy.

Tyler and Huo suggested that process-based regulations, which involve encouraging tax authorities to use fair procedures in exercising their authority, offer several advantages in regard to enhancing cooperation and compliance.³⁷⁸ The strategy, however, only focuses on procedural norms and neglects the effects of structural opportunities and substantive norms. Moreover, procedural norms have limitations in regard to promoting cooperation in countries where social identity remains low. Hence, a process-based regulation can only have limited outcomes in regard to regulating tax evasion in developing countries.

Due to the weak social norms in regard to compliance and the rampant evasion of tax and the corruption involved in this, should Braithwaite's pyramid be applied to China,³⁷⁹ we may end up with an upside-down pyramid; most enterprises need to be

³⁷⁸ Tom Tyler and Yuen Huo, *Trust in the Law: Encouraging Public Cooperation with the Police and Courts* (Russell Sage Foundation 2002) 204, 208.

³⁷⁹ Valerie Braithwaite, 'A New Approach to Tax Compliance' in Valerie Braithwaite (ed), *Taxing Democracy* (Ashgate Publishing 2002) 3.

regulated with potential penalties. When social norms in regard to paying tax are weak, however, can stringent enforcement be effective? The outcome might be similar to obliged compliance, in which taxpayers end up seeking all possible opportunities to evade taxes.

Risk-based responsive regulation suggests that tax authorities' responses vary in regard to the levels of risks occurring in a company. The strategy, however, has limitations. It cannot catch disengaged taxpayers who have not been involved in the tax system, such as naturally invisible taxpayers. More importantly, it neglects the effects of social norms.

Baldwin and Black provided a more comprehensive and broader strategy called the really responsive regulation, which can respond to the attitudinal settings of firms, institutional environment, regulatory tools and strategies, a regime's own performance, and changes in each of these elements.³⁸⁰ This strategy has incorporated aspects of structural opportunity and social norms, but fails to tell tax authorities when and to what extent they should respond to the regulations.

This study suggests that a two-pronged regulatory strategy, considering structural opportunities and social norms at the same time, has several advantages. First, it requires legal authorities to consider to what extent citizens have opportunities to evade tax. Both social and institutional sides should be considered. In particular,

³⁸⁰ Robert Baldwin and Julia Black, 'Really Responsive Regulation' (2008) 71 *The Modern Law Review* 59, 94.

institutional capacity and legal designs can lessen natural invisibility. Second, this strategy also requires the state and authorities to improve social norms by considering individual, horizontal, vertical, and exchange norms. Without one of these aspects, voluntary compliance becomes difficult. The strategy thus not only focuses on the interaction between regulated authorities and regulated actors, but also considers political institutions, legislation, and policy-making. Finally, it helps the government and tax authorities to enhance tax compliance according to the particular features of taxpayers. More effective and efficient regulation of violations thereby becomes more likely.

Drawing on the two-pronged regulatory strategy, to improve the situation in China, given the fact that the social norms are weak there, this study suggests that blocking illegitimate opportunities is crucial to enhancing compliance. To block illegitimate opportunities, tax authorities should improve their ability to track the cash flow and bank accounts of companies, owners, and other relevant individuals. Information disclosure and sharing between tax authorities and other institutions is necessary. Existing studies have already found that these structural factors are needed in China.³⁸¹ Of course, the size and the position of the business in the business chain provide hints for the tax authorities to use when allocating their resources. Only for a tiny percentage of businesses that aspire to be listed or significantly expand should the tax authorities act as consultants and provide training and advice to help them comply

³⁸¹ Jane Winn and Angela Zhang, 'China's Golden Tax Project: A Technological Strategy for Reducing VAT Fraud' (2013) 4 Peking University Journal of Legal Study 1, 33.

with the law. Boosting social norms in regard to compliance, as important as it is, will only become a realistic approach in China when the country's rule of law becomes more established and accepted.

Table 23. Overview of Existing Regulatory Strategies and Limitations

Regulatory strategies	Author (year)	Descriptions	Limitations
Process-based regulation	Tyler and Huo (2002)	Encouraging tax authorities to use fair procedures to develop the public's trust and thus enhance cooperation and compliance.	Limited understanding of structural opportunities and substantive norms.
ATO compliance model	Braithwaite (2001)	Enforcement strategies based on motivational postures.	Limited understanding of the effects of enforcement under weak social norms.
Risk-based responsive regulation	Freedman (2011)	Enforcement strategies based on risk standards	Limited understanding of natural visibility and social norms.
Really responsive regulation	Baldwin and Black (2009)	Response to attitudinal settings, institutional environment, regulatory tools and strategies, the regime's own performance, and changes in each of these elements.	Limited understanding of the extent and timing of responsiveness.

Limitations and Future Research Agenda

Through this thesis, a number of questions have arisen and remain unsolved.

These can be left for future research to address. Four of these aspects are highlighted below.

First, this study conducted fieldwork in southeast China, where the economy is more developed than in other areas of China. Future research could test the framework or compliance dimensions in less developed areas. Regional differences will help us to gain a comprehensive picture of tax compliance in China.

Second, it is difficult to tell whether or not this picture of taxpaying practices can be applied to other industries in China. The situation in other businesses dominated by SOEs may be different. After all, SOEs may trust tax authorities to a greater extent. They may also identify with the ideologies and values of tax laws because SOEs have more opportunities than small and medium size businesses to participate in the law-making process. More empirical evidence is needed to understand the variations that may exist across these business sectors.

Third, besides business taxpayers and tax authorities playing roles in compliance, third parties, such as tax professionals and tax lawyers, complainants, community leaders, and customers, are also significant in influencing compliance practices. The third-party study is of great importance for tax compliance research.

Finally, some broader compliance contexts might be of interest for future research, in order to prove to the extent to which the theoretical framework and typology discussed in this study can be applied to other regulatory contexts in China.

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Appendix

Appendix 1: The General Questions Used in This Study

Compliance

- How often do you issue output invoices to your clients honestly? (*Measuring whether taxpayers hide turnover*)
- How often do you keep input invoices honestly? (*Measuring whether taxpayers cheat on input tax*)

Structural Opportunity to Evade

- How high opportunity do you think you can avoid issuing tax invoices? Why?
- How high opportunity do you think you can keep input invoices dishonestly? Why?

Procedural Norms

- Did tax officials treat you with respect and dignity? (*Measuring dignity*)
- Did tax officials try to be fairly? (*Measuring trustworthiness*)
- Did tax officials give you chance to express your views?(*Measuring procedural control*)
- Did tax officials treat every taxpayer equally?(*Measuring equal treatment*)
- Did tax officials make decisions on facts instead of their own opinions? (*Measuring neutrality*)
- Did tax officials abide the law?(*Measuring lawfulness*)

- Did tax officials respond to your needs and concerns? (*Measuring responsiveness*)

Substantive Norms

- Do you feel that you pay too much in relative to your income? (*Measuring individual norm*)
- Do you feel that you pay more than taxpayers who are in the same boat as you? (*Measuring horizontal norm*)
- Do you feel that you pay more than larger companies? (*Measuring vertical norm*)
- Do you feel that you pay more than smaller companies? (*Measuring vertical norm*)
- Do you feel that you pay more taxes than all social benefits you received? (*Measuring exchange norm*)

Other Questions

- Do you consider that tax revenues collected in your place are used to provide public services?
- How do you rate the quality of local government services (e.g., roads, education, health services, etc.) in your place?
- How dissatisfied or satisfied are you with the way the government spends taxpayers' money?
- Would you be willing to pay more taxes if the public services were improved?

Appendix 2: Overview of the Cases (N=65)

Case code	Cases	Registered year	Market-niche	VAT taxpayer type	Sector	Size ¹	Staff number	2016 revenue reported (Million, RMB)
<i>A. Aggressive evasion</i>								
Q1	Armor	1990	Less regulated	Individually-owned	Shoe materials wholesaler	Micro	5	0.4
Q2	Deer	2006	Less regulated	General	Shoe manufacturer	Small	200	13
Q3	Bumblebee	2005	Less regulated	General	Shoe manufacturer	Medium	2000	45
Q4	Dragon	2001	Less regulated	General	Shoe materials wholesaler	Small	50	13
Q5	Hero	1997	Less regulated	Individually-owned	Shoe materials wholesaler	Micro	16	2.8
Q6	Truly	2011	Less regulated	General	Shoe materials wholesaler	Small	30	25
Q7	Sinda	2005	Less regulated	General	Shoe materials wholesaler	Small	5	20
Q8	Smooth	2011	Less regulated	General	Shoe materials wholesaler	Small	6	15
Q9	Fashion	2009	Less regulated	Without registration	Shoe manufacturer	Small	75	20
Q10	Lion	1999	Less regulated	General	Shoe manufacturer	Small	80	2
Q11	Martin	2010	Less regulated	General	Shoe materials manufacturer	Small	100	2
Q12	Merry	1999	Less regulated	General	Shoe materials manufacturer	Small	150	35
Q13	Youth	1993	Less regulated	General	Shoe manufacturer	Medium	1000	23
S1	Ads	2010	Less regulated	Small	Billboard designer	Micro	5	0.1
S2	Forest	2007	Less regulated	General	Construction service	Small	20	3
S3	Liti	2014	Less regulated	Small	Construction service	Small	10	5
S4	Joy	2016	Less regulated	General	Mould manufacturer	Small	4-6	0.4
S5	Vision	2001	Less regulated	General	Sunglasses wholesaler	Small	8	1
S6	Spring	2012	Less regulated	General	Mould manufacturer	Micro	15	2.03
S7	Stars	2012	Less regulated	General	Packing manufacturer	Micro	30	5
S8	Kay	2017	Less regulated	General	Packing manufacturer	Micro	10	2
S9	Scarlett	2010	Less regulated	General	Hardware mould manufacturer	Small	45	10
S10	Crowd	2011	Less regulated	General	Hardware manufacturer	Micro	8	2
S11	Xinqi	2014	Less regulated	General	Machine mould manufacturer	Micro	12	2
S12	Through	2014	Less regulated	General	Hardware mould manufacturer	Micro	4	0.6
S13	Master	2014	Less regulated	Small	Business cards manufacturer	Micro	30	2.5
S14	Wood	2012	Less regulated	General	Paper wholesaler	Micro	8	3
S15	Putian	2012	Less regulated	General	Paper manufacturer	Micro	5	2
<i>B. Obligated compliance</i>								
Q14	King	2002	More regulated	General	Shoe manufacturer	Small	200	40
Q15	New Nam	1993	More regulated	General	Shoe manufacturer	Medium	350	30
Q16	Calais	1990	More regulated	General	Shoe manufacturer	Medium	2000	300
Q17	Simba	2000	More regulated	General	Shoe manufacturer	Medium	300	50
Q18	Anput	1994	More regulated	General	Shoe manufacturer	Medium	600	120
Q19	Sharp	1998	More regulated	General	Shoe manufacturer	Medium	800	60
Q20	Step	1996	More regulated	General	Shoe manufacturer	Medium	160	50
Q21	Bright	1997	More regulated	General	Shoe manufacturer	Small	100	24
Q22	Cowboys	2011	More regulated	General	Shoe manufacturer	Small	200	15
Q23	Swift	2001	More regulated	General	Shoe manufacturer	Medium	500	90

Q24	Fortune	1990	More regulated	General	Shoe manufacturer	Medium	1000	150
Q25	Central	1987	More regulated	General	Shoe manufacturer	Medium	300	45
Q26	Super	1992	More regulated	General	Shoe manufacturer	Medium	250	120
Q27	Energy	1995	More regulated	General	Shoe manufacturer	Small	150	30
Q28	Tripod	2010	More regulated	General	Shoe manufacturer	Small	50	20
Q29	Laden	2003	More regulated	General	Shoe manufacturer	Large	800	500
Q30	Golden	2011	More regulated	General	Shoe manufacturer	Medium	1200	250
Q31	Leather	1991	More regulated	General	Shoe manufacturer	Small	200	38
Q32	Crystal	2010	More regulated	General	Shoe manufacturer	Small	80	35
S16	Triump	2014	More regulated	General	Hardware manufacturer	Micro	5	0.5
S17	Dawn	2007	More regulated	General	Hardware mould manufacturer	Micro	11	1
S18	Steam	2016	More regulated	General	Hardware mould manufacturer	Micro	5	1
S19	Yao	2013	More regulated	General	Hardware mould manufacturer	Micro	8	1.52
S20	Universe	2011	More regulated	General	Hardware mould wholesaler	Small	8	3
S21	Model	2015	More regulated	General	Hardware mould manufacturer	Small	10	3
S22	Pie	2016	More regulated	General	Hardware mould manufacturer	Micro	5-6	0.5
S23	Wheet	2013	More regulated	General	Hardware mould manufacturer	Small	10	6.05
S24	Fang	2010	More regulated	General	Paper manufacturer	Micro	14	1.58
S25	Zeng	2011	More regulated	General	Electronic part manufacturer	Small	20	2
S26	Entel	2012	More regulated	General	Electronic part manufacturer	Small	90	22
S27	May	2014	More regulated	General	Hardware mould manufacturer	Small	18	5
S28	Horse	2014	More regulated	General	Sports goods manufacturer	Micro	15	1
S29	Grad	2011	More regulated	General	Electronic part manufacturer	Small	32	4.5
S30	Vilter	2013	More regulated	General	Electronic part manufacturer	Micro	35	2.75

C. Strategic compliance

Q33	Norkey	1993	Less regulated	General	Shoe materials manufacturer	Medium	1000	45
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D. Voluntary compliance

Q34	Pace	1999	More regulated	General	Shoe manufacturer	Large	3500	5300 ²
Q35	Shaw	1993	More regulated	General	Shoe materials manufacturer	Medium ₄	800	147 ³

¹ Business size is based on the State Council's *The Small and Medium Enterprises Standards*

(Zhongxiao Qiye Huaxing Biaozhun Guiding/中小企业划型标准规定, effective 2011). The number of employees and annual revenues were considered. See the following table for the detailed standards:

	Manufacturing	Wholesale
Micro	<20 employees or <3 million	<5 employees or <10 million
Small	≥ 20employees and ≥3 million	≥ 5employees and ≥10million
Medium	≥300employees and ≥20 million	≥20employees and ≥50 million
Large	≥1000employees and ≥400 million	≥200employees and ≥400 million

² Pace's annual revenue was from 2015.

³ Shaw's annual revenue was from 2015.

⁴ When Shaw was listed in 2010, its annual revenue had reached 500 million.

Appendix 3: Profile of the Informants (N=112)

Informants of the Companies (N=68)

(Q1-Q36 are from City Q, and S1-S31 are from City S)

Q1. Armor, owner, male, 21-30 years old, single, bachelor's degree, Hui Minority,
CPC member;

Q2. Deer, financial manager, male, 31-40 years old;

Q3. Bumblebee, financial manager, female, 41-50 years old, married;

Q4. Dragon, financial manager, female, 21-30 years old, single, senior high school,
Hui Minority;

Q5. Hero, owner, male, 41-50 years old, married, junior high school, Hui Minority;

Q6. Truly, owner, male, 31-40 years old, divorced, junior high school;

Q7. Sinda, owner, 41-50 years old, male, married, junior high school;

Q8. Smooth, owner, male, 41-50 years old, married, junior high school, Hui Minority;

Q9. Fashion, owner, male, 31-40 years old, married, junior high school;

Q10. Lion, owner, male, 51-60 years old, married, CPC member;

Q11. Martin, owner, male, 41-50 years old, married, senior high school, Hui
Minority;

Q12. Merry, owner, male, 61 years old or above, married, junior high school, CPC
member;

- Q13. Youth, owner, male, 31-40 years old, married, college;
- Q14. King, owner, male, 41-50 years old, married, junior high school, Hui Minority;
- Q15. New Nam, owner, male, 31-40 years old, married, college;
- Q16. Calais, owner, male, 41-50 years old, married, junior high school;
- Q17. Simba, owner, male, 51-60 years old, married, primary school;
- Q18. Anput, financial manager, female, 41-50 years old, married;
- Q19. Sharp, financial manager, male, 41-50 years old, married, junior high school;
- Q20. Step, financial manager, female, 31-40 years old, married, college;
- Q21. Bright, financial manager, female, 41-50 years old, married, senior high school;
- Q22. Cowboys, owner, male, 41-50 years old, married, senior high school;
- Q23. Swift, owner, male;
- Q24. Fortune, financial manager, male, 51-60 years old, married, junior high school;
- Q25. Central, financial manager, male, 21-30 years old, single, senior high school;
- Q26. Super, financial manager, male, 51-60 years old, married, junior high school,
CPC member;
- Q27. Energy, owner, male, 41-50 years old, married, junior high school, Hui
Minority;
- Q28. Tripod, owner, male, 41-50 years old, married, senior high school, Hui
Minority, non-local;

- Q29. Laden, financial manager, male, 31-40 years old, married, bachelor's degree,
Hui Minority, CPC member;
- Q30. Golden, financial manager, female, 31-40 years old, married, college, non-local;
- Q31. Leather, owner, male, 41-50 years old, married, senior high school, Hui
Minority;
- Q32. Crystal, owner, female, 31-40 years old, married, senior high school;
- Q33A. Norkey, owner, male, 41-50 years old, married, senior high school, Hui
Minority;
- Q33B. Norkey, financial manager, female, 31-40 years old, married, junior high
school;
- Q34. Pace, financial manager, female, 31-40 years old, married, bachelor degree, Hui
Minority;
- Q35. Shaw, financial manager, female, 31-40 years old, married, bachelor's degree;
- Q36. Ms. Huang, financial manager, female, 41 years old, married, senior high
school;
- S1. Ads, financial manager, female, 31-40 years old, married, junior high school, non-
local;
- S2. Forest, owner, male, 31-40 years old, married, bachelor degree, non-local;
- S3. Liti, owner, male, 41-50 years old, married, college, non-local;
- S4. Joy, owner, male, 31-40 years old, married, college, non-local;

- S5. Vision, financial manager, female, 31-40 years old, married, senior high school, non-local;
- S6. Spring, owner, male, 41-50 years old, married, senior high school, non-local;
- S7. Stars, financial manager, female, 21-30 years old, married, college, non-local;
- S8. Kay, owner, female, 31-40 years old, married, junior high school, non-local, Christian;
- S9. Scarlett, owner, male, 31-40 years old, married, college, non-local;
- S10. Crowd, owner, male, 41-50 years old, married, senior high school, non-local;
- S11. Xinqi, owner, male, 31-40 years old, married, senior high school, non-local;
- S12. Through, owner, male, 51-60 years old, married, bachelor's degree, non-local;
- S13. Master, owner, male, 31-40 years old, married, junior high school, non-local;
- S14. Wood, owner, female, 31-40 years old, married, junior high school, non-local;
- S15. Putian, owner, male, 41-50 years old, married, junior high school, non-local;
- S16. Triumph, owner, male, 41-50 years old, married, senior high school, local;
- S17. Dawn, financial manager, female, 41-50 years old, married, college, non-local, Christian;
- S18. Steam, owner, male, 31-40 years old, married, junior high school, non-local;
- S19. Yao, owner, male, 41-50 years old, married, junior high school, non-local;
- S20. Universe, financial manager, female, 21-30 year old, married, college, non-local;

- S21. Model, owner, male, 41-50 years old, married, senior high school, non-local;
- S22. Pie, owner, male, 31-40 years old, married, senior high school, non-local,
Christian;
- S23. Wheet, financial manager, female, 31-40 years old, married, bachelor's degree,
local;
- S24. Fang, owner, male, 31-40 years old, married, senior high school, non-local;
- S25. Zeng, owner, male, 41-50 years old, married, without education, non-local;
- S26. Entel, financial manager, female, 31-40 years old, married, bachelor's degree,
non-local, Christian;
- S27. May, owner, male, 41-50 years old, married, senior high school, non-local;
- S28. Horse, owner, male, 31-40 years old, married, senior high school, non-local;
- S29. Grad, financial manager, female, 41-50 years old, married, non-local;
- S30. Vilter, owner, male, 31-40 years old, married, non-local.
- S31. Mr. Zhu, tax specialist, 41-50 years old, married, non-local, Christian.

Tax Officials (N=34)

(P1-P21 are from Bureau P, R1- R13 are from Bureau R)

- P1. Male, 42 years old, bachelor's degree, chief of fifth tax branch, from County J, worked in tax authorities for 20 years, CPC member, worked as tax administrator, chief of administrative office, and vice chief of tax branch before;
- P2. Male, 46 years old, bachelor's degree, vice chief of fifth tax branch, from County J, worked in tax authorities for 25 years, CPC member, worked as vice chief of a tax branch and auditor of audit bureau before;
- P3. Male, 40 years old, bachelor's degree, vice chief of fifth tax branch, from County J, worked in tax authorities for 19 years, CPC member, worked as auditor in audit bureau before;
- P4. Male, 55 years old, college's degree, tax administrator of fifth tax branch, from County J, worked in tax authorities for 31 years, worked as tax administrator of a tax branch before;
- P5. Male, 53 years old, college's degree, tax administrator of fifth tax branch, from County J, worked in tax authorities for 30 years, worked as tax administrator of a tax branch before;
- P6. Female, 29 years old, bachelor's degree, tax administrator of fifth tax branch, from County J, worked in tax authorities for 4 years, CPC member;

P7. Male, 25 years old, bachelor's degree, tax administrator of fifth tax branch, from the downtown of the city, worked in tax authorities for less than 2 years, CPC member;

P8. Male, 53 years old, bachelor's degree, chief of audit bureau, from County J, worked in tax authorities for 31 years, CPC member, worked as chief of a tax branch before;

P9. Female, 37 years old, master's degree, vice chief of audit bureau, from County J, worked in tax authorities for 10 years, CPC member, worked as tax administrator of a tax branch before;

P10. Male, 52 years old, college's degree, auditor of audit bureau, from County J, worked in tax authorities for 30 years, CPC member;

P11. Male, 54 years old, bachelor's degree, chief of first tax branch, from County J, worked in tax authorities for 32 years, CPC member, worked as vice chief of a tax branch before;

P12. Male, 50 years old, college's degree, vice chief of first tax branch, from County J, worked in tax authorities for 30 years, CPC member;

P13. Male, 45 years old, bachelor's degree, chief of sixth tax branch, from County J, worked in tax authorities for 23 years, CPC member;

- P14. Male, 40 years old, bachelor's degree, chief of department of administration of tax collection, from County J, worked in tax authorities for about 20 years, CPC member;
- P15. Male, 45 years old, bachelor's degree, vice chief of department of administration of tax collection, from County J, worked in tax authorities for about 20 years, CPC member;
- P16. Male, 45 years old, bachelor's degree, chief of tax service hall/centre, from County J, worked in tax authorities for about 20 years, CPC member;
- P17. Male, 30 years old, master's degree, staff of department of policies and regulations, from County J, worked in tax authorities for 3 years, CPC member;
- P18. Male, 52 years old, college's degree, tax administrator of sixth tax branch, from County J, worked in tax authorities for 30 years, CPC member;
- P19. Female, 45 years old, bachelor's degree, chief of fourth tax branch, from County J, worked in tax authorities for 20 years, CPC member;
- P20. Female, 40 years old, bachelor's degree, staff, worked in department of administration of tax collection for 19 years, CPC member, from County J;
- P21. Male, 45 years old, bachelor's degree, staff, worked in department of administration of tax collection for 20 years, CPC member, from County J;

- R1. Male, 56 years old, college's degree, chief, from County J, worked in tax authorities for 36 years, CPC member, worked as chief of department of policies and regulation of city tax office before;
- R2. Male, 51 years old, bachelor's degree, vice chief, from County J, worked in tax authorities for 32 years, CPC member;
- R3. Male, 34 years old, bachelor's degree, taking charge of tax administration, from County J, worked in tax authorities for 11 years, CPC member;
- R4. Male, 35 years old, bachelor's degree, taking charge of tax service hall/centre, worked in tax authorities for 10 years, CPC member, from County J, worked as tax administrator before;
- R5. Male, 34 years old, bachelor's degree, tax administrator, worked in tax authorities for 6 years, CPC member, from downtown of the city;
- R6. Male, 40 years old, bachelor's degree, tax administrator, worked in tax authorities for 5 years, from County J, CPC member, worked as tax administrator in the other city before;
- R7. Male, 34 years old, bachelor's degree, tax administrator, worked in tax authorities for 7 years, CPC member, from County J;
- R8. Female, 29 years old, bachelor's degree, staff, worked in administrative office for 6 years, from the other county of the city, CPC member;

- R9. Female, 28 years old, bachelor's degree, staff, taking charge of data analysis for 5 years, from County J, CPC member;
- R10. Male, 32 years old, bachelor's degree, tax administrator, worked in tax authorities for 9 years, from County J, CPC member;
- R11. Female, 25 years old, bachelor's degree, staff, taking charge of issuing tax invoices in tax service centre for 3 years, from County J, CPC member;
- R12. Female, 30 years old, master's degree, staff, worked in department of administration of tax collection in city local tax office for 5 years, from County J, CPC member;
- R13. Male, 45 years old, bachelor's degree, chief of department of tax policies and regulations in city local tax office, worked in tax authorities for 25 years, from County J, CPC member.

Other Informants (N=10)

The informants were interviewed when I was doing the preliminary investigations in the City Z.

- Z1. Female, 29 years old, bachelor's degree, accountant of a large real property company, from City Z, worked for 4 years in the company;
- Z2. Female, 38 years old, college's degree, accountant of a chemical factory, from City Z, worked for more than 8 years in the company;
- Z3. Female, 27 years old, college's degree, accountant of a trading company of grain, from City Z, worked for around 4 years in the company;
- Z4. Male, 58 years old, college's degree, from City Z, self-employed, worked as part-time tax preparer for more than 30 years;
- Z5. Female, 36 years old, college's degree, accountant of a concrete company, from City Z, worked in the company for 6 years;
- Z6. Male, 46 years old, college's degree, head of an accounting company with 7 accountants, worked as an accountant for more than 20 years, from the County J, City Z;
- Z7. Female, 29 years old, bachelor's degree, worked for 5 local companies, from City Z, worked as a part-time tax preparer for 6 years.
- Z8. Female, 28 years old, bachelor's degree, worked in a 4S car company, from City Z, worked as an accountant for 4 years.

Z9. Female, 52 years old, college's degree, accountant, worked in a bath centre and an architecture company, from City Z, worked as an accountant for 20 years.

Z10. Female, 36 years old, bachelor's degree, accountant, worked in a manufacturing company, from City Z, worked as an accountant for 12 years.