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Free Trade, RMB Internationalization, and Tax Reform Commitments

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Reform Path Forward for China's Tax Law Reform

The observation on the current fiscal and tax system helps China to improve and execute a profound tax system to realize goals proposed in The Decision as well as tackling new challenges arising therefrom. Fiscal and tax policies do not stand alone and must follow the fiscal tradition developed over the past two decades. Moreover, it should be embedded into China's development landscape in the medium- or long-run. The reform of the fiscal and tax system for the near future should consider the following four-layer program.

This post discusses the first layer of problem regarding the recently heavily debated topics on China's efforts to internationalize its currency.

Commitment to Innovative Reform in Free Trade Areas and Promoting the internationalization of RMB

It would be too ambitious to design an immediately executable fiscal and tax reform plan all over China. Promoting the fiscal and tax system reform gradually through the establishment and deepening reform of free trade areas should be an efficient measure for the tax system reform. Tailored and applicable incentives should be prioritized for special economic zones of national interests, such as the Shanghai Pilot Free-Trade Zone established in September 2013. The goal is to liberalize investment, trade interest rates, and accelerate development of financial sectors. A series of preferential customized tax incentives should be further administered to accommodate goals thereof, including payment of income tax by installments for certain assets, export rebates for finance leases, exemption of import tariffs for imported machinery and equipment, and extended tax holidays for specified industries such as finance, leasing and TMT, etc.

Another similarly important zone is the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone ("Qianhai") located on the borders of Shenzhen and Hong Kong. Given Qianhai's geographical merits and Hong Kong's prominence as an international hub for financial services, international settlement, and supply chain management, Qianhai's experimental significance for reforming the tax and financial sectors should be further explored. Tax incentives should be designed to be innovative and to encourage free flow and full convertibility of capitals denominated in RMB, such as an extended tax holidays for investment in the form of outbound

RMB capital account, zero tax for profits from RMB capital invested in supply chain or financial service industries, etc.

Qianhai's tax policies should also be commensurate with the cutting-edge dispute resolution mechanisms such as adopting Hong Kong arbitration rules; therefore, the tax collection and administration could be less venerable in enforcement. Furthermore, Qianhai's tax incentives should also help promoting the internationalization of RMB and [achieving the full convertibility of the RMB under capital account](#) for certain industries. Therefore, Chinese leaders should give more weight to better exploit the advantages of Qianhai for reforming relevant local tax systems.

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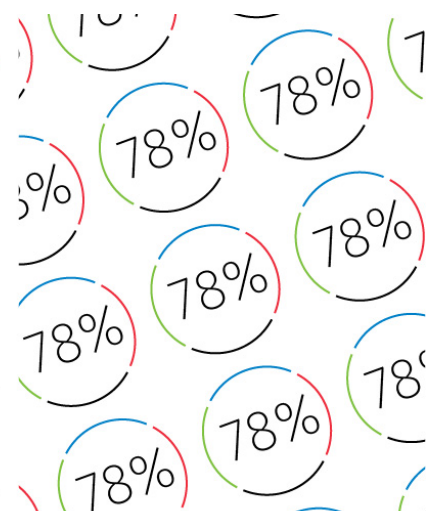
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This entry was posted on Monday, April 27th, 2015 at 8:48 am and is filed under [Tax Policy](#)

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