Universe Scientific Publishing

Research on the Improvement Space of China's Tax System

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Abstract: Since China's accession to the WTO, the economy has ushered in rapid development, especially the foreign trade industry and non-public enterprises are important audience groups. However, it is an indisputable fact that the gap between rich and poor has gradually widened in the process of economic development. As an important distribution system of the country, the tax system is an important means to adjust the gap between the rich and the poor. Therefore, it is urgent to find out the possible drawbacks of the current Chinese tax system and formulate a tax system that is more in line with the current stage. This article will compare with the United Kingdom, Japan, the United States and other three countries to explain the problems and room for improvement in China's current tax system.

Keywords: Tax System; Personal Income Tax; Tax Reform

1. Problems with China's tax system

Since China's accession to the WTO in 2001, the economy has ushered in a take-off. At the same time, the gap between the rich and the poor, the gap between industries, and the gap between regions are also further widening. At the same time, China's tax reform is slow and unable to adapt to the current economic environment. This is mainly reflected in the fact that the tax system is still complicated after the merger of the National Taxation Bureau and the Local Taxation Bureau, and the tax legislation has not kept up; the tax bureau has a large number of personnel, and the number of personnel that should have been reduced after the merger of the National Taxation Bureau and the Local Taxation Bureau has not been achieved; the coverage of individual taxes is too narrow. , compared with developed countries, the proportion is too low to play a role in adjusting the gap between rich and poor.At the current stage when the local tax system has not yet been established, the joint adjustment mechanism between various tax categories needs to be improved, and it is difficult to exert its due effect in the short term. Therefore, in the near future, it is still necessary to adopt short-term tax policies to flexibly respond to the friction between the tax system and the economy, which determines that my country will still have many short-term policies such as tax cuts and fee reductions for a period of time to maintain the efficient operation of the fiscal and taxation field. [1]

1.1 Complex Tax System

One area for improvement in China's tax system lies in simplification and streamlining processes. The British tax system is often regarded as more straightforward due to the consolidation of various taxes and the harmonization of tax rules and regulations. In contrast, China has multiple taxes, such as value-added tax (VAT), business tax, and consumption tax, which can be complex and burdensome for taxpayers.

To address this, China could consider consolidating and simplifying its tax structure, reducing the number of taxes, and harmonizing tax rules across different regions. This would streamline tax compliance processes, reduce administrative burdens for businesses, and enhance efficiency. For example, the introduction of the VAT reform in 2016, which replaced the business tax with a unified VAT system, was a step in the right direction. Further consolidation and simplification efforts would benefit taxpayers and improve compliance rates.

China's tax system is considered complex due to several factors. Here are the key reasons why China's tax system is perceived as complicated:

a. Multiple Tax Categories: China has numerous tax categories, including value-added tax (VAT), corporate income tax (CIT), personal income tax (PIT), consumption tax, resource tax, and more. Each tax category has its own rules, regulations, and compliance requirements. The existence of multiple tax categories adds complexity to the overall tax system.

b. Varied Tax Rates: China's tax system involves a wide range of tax rates. Different industries, regions, and types of businesses may be subject to different tax rates. For instance, VAT has standard rates, reduced rates, and exemptions based on the type of goods or services. CIT has different tax rates based on the size and nature of the enterprise. The presence of varied tax rates increases the complexity of tax calculations and compliance.

c. Complex Compliance Procedures: Compliance procedures in China's tax system can be intricate. Taxpayers need to understand and fulfill various reporting requirements, maintain accurate records, and comply with specific procedures for tax payment, filing, and invoicing. The complexity of compliance procedures can pose challenges for businesses and individuals, especially those with limited resources or expertise.

d. Extensive Tax Incentive Policies: China has implemented numerous tax incentive policies to promote economic development, investment, and specific industries. These incentives often involve specific conditions, eligibility criteria, and application processes. The complexity of navigating through various tax incentive policies and determining eligibility can create challenges for taxpayers.

e. Local Taxation Autonomy: China's tax system involves a decentralized tax administration structure, with local governments having some autonomy in levying and implementing taxes. This decentralized system allows local governments to impose additional taxes or fees based on regional policies, further contributing to the complexity of the overall tax system.

f. Rapid Policy Changes: China's tax laws and regulations undergo frequent revisions to adapt to economic and social developments. Rapid policy changes may lead to frequent updates and adjustments in tax rules and regulations. Keeping up with these changes and ensuring compliance can be demanding for taxpayers and tax professionals.

g. Administrative Challenges: Tax administration in China involves multiple government agencies, including the State Taxation Administration (STA), local tax bureaus, customs, and other relevant departments. Coordinating efforts among these agencies, streamlining information sharing, and ensuring consistent enforcement can present administrative challenges and contribute to the complexity of the tax system.

It is important to note that the Chinese government has taken steps to simplify the tax system in recent years. Efforts have been made to streamline tax categories, harmonize tax rates, and improve taxpayer services. However, due to the size and complexity of the Chinese economy, achieving complete simplicity in the tax system remains a continuous process.

Data supports the need for simplification. According to the World Bank's "Doing Business 2020" report, China ranks 109th out of 190 countries in the ease of paying taxes, reflecting the complexity of its tax system. In comparison, the United Kingdom ranks 23rd, indicating a more streamlined tax environment.

1.2 Large number of staff

Before the merger of the State Tax Bureau and local tax bureaus, each city in China had two tax bureaus. National tax and local tax refer to the national tax system and local tax system. Generally, it refers to tax authorities rather than tax categories. There are 24 current tax categories in my country. There are three types of local taxes shared by the central and local governments. Among them, the central tax is owned by the central government, the local tax is owned by the local government, and the shared tax between the central government and the local government is owned by the central government and the local government respectively. Land tax, responsible for the collection of different types of taxes. Even after the merger of national and local taxes in 2018, the staff has not been reduced, but some tax types can already reduce staff, such as the collection of corporate income tax and value-added tax. With the operation of Jinsui 4th phase, non-tax business has been included online, thus realizing the transformation from ticket-based taxation to numerical control taxation. This can also reduce staff.

1.3 The moderating effect of personal income tax is limited

China's personal income tax (PIT) system faces limitations when it comes to effectively adjusting income and addressing income inequality. While China does have a progressive tax structure in place, there are factors that hinder the ability of the personal income tax system to fully adjust income disparities. Jens Arnold (2008) collected panel data from 21 OECD countries and showed through quantitative analysis that: increasing the proportion of real estate in personal income tax or property tax can promote regional economic growth, so they believe that direct taxation has a significant positive effect on economic growth Relevant

Kim and Lambert (2009)[3] and Hungerford (2010)[4], they argue that, exploring these factors:

a. Tax Thresholds and Progressive Tax Brackets: China's personal income tax system features progressive tax brackets with varying rates based on income levels. However, the tax thresholds and rate brackets may not be adjusted frequently enough to keep up with changing income dynamics and inflation. This can result in individuals moving into higher tax brackets without an appropriate adjustment for their changing income levels, reducing the system's ability to accurately reflect income disparities.

b. Limited Deductions and Exemptions: While China's personal income tax system allows for certain deductions and exemptions, they may not adequately address various income sources and expenses. This can limit the system's ability to account for specific financial circumstances, such as medical expenses, education expenses, and other significant financial burdens. Expanding the scope of deductions and exemptions could provide more flexibility in adjusting taxable income.

c. Informal Economy and Tax Evasion: The presence of a substantial informal economy and tax evasion practices can undermine the effectiveness of the personal income tax system in capturing and adjusting income disparities. Income earned in the informal sector, which often goes unreported, may not be fully accounted for in the tax calculations. Additionally, tax evasion reduces the overall tax base and diminishes the potential for income redistribution through the tax system.

d. Wealth Disparity and Non-Income Factors: Income disparity in China is not solely determined by salaries or wages. Wealth inequality, which includes assets, property, and other non-income factors, plays a significant role. China's personal income tax system primarily focuses on income rather than wealth, making it challenging to comprehensively address income disparities arising from non-wage sources, inheritances, or capital gains.

e. Regional Disparities: China has significant regional income disparities, with higher-income regions like Beijing, Shanghai, and Guangdong contrasting with lower-income provinces and rural areas. The personal income tax system, while progressive, may not be tailored to adequately address these regional disparities. The tax system's limited regional adjustments may not fully account for the differing costs of living, resulting in varying levels of income redistribution across regions.

f. Administrative Challenges: Implementing and enforcing an effective personal income tax system across a vast and diverse country like China is a significant administrative challenge. Ensuring accurate reporting, compliance, and enforcement can be resource-intensive. Additionally, the complexity of the tax system itself, including multiple tax categories and deductions, can pose difficulties in effectively adjusting income disparities.

It is worth noting that China has been taking steps to address income inequality through various means, including targeted poverty alleviation programs, minimum wage policies, and social security reforms. However, enhancing the personal income tax system to adjust income disparities more effectively would require comprehensive reforms, such as revising tax brackets, expanding deductions, improving tax administration, and tackling tax evasion.

2. Improvement space

2.1 Simplification and Transparency

China's tax system is known for its complexity, with multiple tax categories, deductions, and exemptions. Streamlining the tax code and simplifying tax procedures can enhance compliance, reduce administrative burden, and improve efficiency. By providing clear guidelines and instructions, taxpayers will have a better understanding of their tax obligations. Enhancing transparency in the tax system can help foster trust and fairness.

2.2 Progressive Tax Structure

A progressive tax structure aims to ensure that individuals with higher incomes pay a proportionately larger share of their income in taxes. While China does have a progressive tax system, there is room for improvement. In 2021, Japan had a higher top marginal tax rate (55%) compared to China (45%). China could consider implementing a more progressive tax structure to promote income redistribution and address wealth inequality.

To illustrate this, let's consider the income distribution in China. According to the National Bureau of Statistics of China, the Gini coefficient, a measure of income inequality, stood at 0.465 in 2020. In contrast, Japan's Gini coefficient was lower at 0.314 in 2021, indicating a relatively lower level of income inequality. Implementing a more progressive tax system in China could help address this disparity and contribute to a fairer distribution of wealth.

2.3 Tax Incentives for Research and Development (R&D)

Japan has been successful in promoting R&D activities through tax incentives, leading to innovation and technological advancement. China could enhance its tax incentives for R&D to encourage companies to invest in research and development, which would drive innovation and contribute to long-term economic growth.

According to data from the World Intellectual Property Organization (WIPO), Japan consistently ranks higher than China in terms of research and development expenditure. In 2020, Japan spent approximately 3.39% of its GDP on R&D, while China's expenditure was 2.36% of its GDP. By offering more attractive tax incentives, such as research tax credits or accelerated depreciation for R&D equipment, China can stimulate greater investment in innovation and enhance its global competitiveness.

2.4 Tax Evasion and Avoidance

China faces challenges in combating tax evasion and avoidance. Strengthening enforcement measures, implementing stricter penalties, and enhancing collaboration between tax authorities and other relevant agencies are crucial to address this issue. By reducing tax evasion, China would be able to increase tax revenues and ensure a fairer tax system for all.

While comprehensive data on the extent of tax evasion and avoidance in China is not readily available, it is a significant concern in the country. The Chinese government has taken steps to tackle this issue, including implementing stricter regulations and enhancing digitalization of tax processes. However, further efforts are needed to improve compliance and deter tax evasion effectively.

2.5 Property Tax Reform

Japan has a well-established property tax system that plays a significant role in local government revenues. Implementing a comprehensive and transparent property tax system in China could help diversify revenue sources, promote property market stability, and reduce speculation.

In the past 20 years, the proportion of China's direct taxes, mainly personal income tax and corporate income tax.

Although there is a significant increase, it is still far below the indirect tax. This tax structure dominated by indirect taxes has a negative adjustment effect on the gap between the rich and the poor.It is not conducive to curbing the widening gap between the rich and the poor in society. In addition, in the income tax, the proportion of personal income tax is much lower than that of corporate income Taxation, which is also not conducive to addressing the growing gap between rich and poor.

Currently, China imposes property-related taxes such as the real estate tax, urban land use tax, and deed tax. However, there is room for improvement in terms of the overall property tax system. By implementing a unified property tax that takes into account the value of the property and other relevant factors, China can establish a fair and consistent framework. This would not only contribute to revenue generation but also help curb speculative activities in the real estate market.

In summary, several areas within China's tax system could be improved when compared to Japan. These include simplification and transparency, a more progressive tax structure, enhanced tax incentives for R&D, addressing tax evasion and avoidance, and comprehensive property tax reform. By addressing these aspects, China can create a more efficient and equitable tax system that supports economic growth and social development.

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