Analysis of Effect of “the Replacement of Business Tax by Value-Added Tax” in the Construction Industry and Suggestions

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Abstract. Purposes: This thesis demonstrates the effects of "the replacement of business tax by value-added tax (VAT)" on the construction industry and the results of this policy and put forward relevant suggestions. Methods: documentary analysis, statistical analysis. Results: There are many problems about the implementation of "the replacement of business tax by value-added tax", such as no specific regulations of the designation of tax payment places, a lack of VAT deduction chain between upstream and downstream enterprises, the great difficulty of tax supervision by the government, etc. Conclusion: The government should expedite the institutionalization of "the replacement of business tax by value-added tax" in the construction industry and expand the pilot scope in various regions and industries. It should also intensify the supervision over tax payment and management so as to improve the management level.

Background and Theoretical Basis

Background. VAT is collected on the added value in the commodity production, circulation, labor and service links but not on the cost in the intermediate link. Therefore, it is well-accepted worldwide for its characteristic of neutral tax. The business tax and VAT co-exist in China's current circulation tax system. However, as the product of the development of China's market economy system, it was identified as the main objective and task of the economic development that we should "accelerate the transformation of economic development pattern and restructure the domestic economy"[1]. The existing circulation tax system is found unreasonable somehow and exert an increasingly negative impact on the economy. Since the implementation of VAT in our country, there has been no complete tax deduction chain in the commodity production, circulation and other links, which caused problems like overlapping tax and tax injustice.

To tackle the problems caused by the existing tax system, which allows the co-existence of VAT and business tax, "CCCPC's advice on the formulation of the twelfth five-year plan for national economic and social development" was passed in CPC's fifth plenary session of the 17th Central Committee in October 18, 2010 and required "the expansion of the deduction scope of VAT and the according reduction of business and other taxes"[2]. Since November 16, 2011, when "The Pilot Program of the Replacement of Business Tax by VAT" was published after the stipulation by the State Committee, the relevant actions began.

Tax Incidence Theory. Tax incidence refers to the foothold of the tax burdens being transformed and is a kind of theoretical abstraction. If the transforming process of the tax burdens is to be analyzed in the enterprise and individual level, the tax incidence equals to tax barer [3]. From the economic aspect, the real tax barer may differ from the legal tax barer in real life. Graph 1 suggests the increase of tax burden in the society as a whole, but this burden is borne jointly by consumers and enterprises, and how much each party will bear is determined by the elastic curve. Through analyses, we can find that in the construction industry, the enterprises bare more burden than consumers, which is due to the greater elasticity of consumers. This is the invisible increase of tax burden of enterprises in the construction industry after "the replacement of business tax by value-added tax (VAT)". They may reduce some of the tax burden we can observe after the improvement of chains, but it is still subject to the specific situation of each enterprise whether this kind of burden reduction can offset the invisible burden increase.
Data Statistics and Analysis of Difficulties

Data Statistics. I analyzed the contradictions between central and local tax revenue through the statistics of national tax revenue and fiscal expenditure in 2014. Utilizing method of statistical analysis, I calculated the tax data in construction industry before "the replacement of business tax by value-added tax (VAT)"(in 2005, 2007 and 2010), compared the tax effect of the business tax rate of 3% and that of the value-added tax rate of 11% and then worked out the impacts imposed by "the replacement of business tax by value-added tax" on the tax revenue in the construction industry.

Table 1  The national tax revenue and fiscal expenditure in 2014 after "the replacement of business tax by value-added tax "[4]

<table>
<thead>
<tr>
<th>Years</th>
<th>total volume of national tax revenue</th>
<th>central-level tax revenue</th>
<th>percentage of central tax revenue</th>
<th>local tax revenue</th>
<th>percentage of local tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>tax revenue</td>
<td>103768</td>
<td>44973</td>
<td>43.3%</td>
<td>58795</td>
<td>56.7%</td>
</tr>
<tr>
<td>fiscal expenditure</td>
<td>151662</td>
<td>22570</td>
<td>14.9%</td>
<td>129092</td>
<td>85.1%</td>
</tr>
</tbody>
</table>

VAT is the most important circulation tax in China. Under the former tax revenue sharing mechanism, VAT in export section was included by central tax revenue while in domestic section shared by central and local governments at a rate of 75:25. Except the part concentrated-paid by the railway corporation and the head offices of various banks, all other business tax went to local governments. After "the replacement of business tax by value-added tax" in construction industry, the business tax that used to be paid solely to the local government were transformed into VAT shared by central and local governments, which reduced the local tax revenue to a great extent. Table 1 indicates that in 2014, the central tax revenue took up 43.3% of the total volume of national tax revenue and the local government 56.7%. However, in terms of fiscal expenditure, the central government accounted for 14.9%, while the local government 85.1%. Imbalance between fiscal revenue and expenditure aggravated the contradiction between the central and local government and make it difficult for "the replacement of business tax by value-added tax" to go further.
表2 建筑业在“改征增值税”之前“改征营业税”的营业税

<table>
<thead>
<tr>
<th>Years</th>
<th>total output of construction industry in China</th>
<th>business tax rate for the construction industry</th>
<th>the amount of payable business tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>34,552.10</td>
<td>3%</td>
<td>1,036.56</td>
</tr>
<tr>
<td>2007</td>
<td>51,043.71</td>
<td>3%</td>
<td>1,531.31</td>
</tr>
<tr>
<td>2010</td>
<td>96,031.13</td>
<td>3%</td>
<td>2,880.93</td>
</tr>
</tbody>
</table>

表3 建筑业增值税取代营业税对财政收入的影响

<table>
<thead>
<tr>
<th>Years</th>
<th>the amount of payable VAT after &quot;the replacement of business tax by value-added tax&quot;</th>
<th>the amount of payable business tax before &quot;the replacement of business tax by value-added tax&quot;</th>
<th>the increased amount of input VAT deduction from services for other industries</th>
<th>the reduced amount of circulation tax after &quot;the replacement of business tax by value-added tax&quot;</th>
<th>the reduced and increased amounts of enterprise income tax after &quot;the replacement of business tax by value-added tax&quot;</th>
<th>the reduced and increased amounts of fiscal revenue after &quot;the replacement of business tax by value-added tax&quot;</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>105.56</td>
<td>1036.56</td>
<td>84.58</td>
<td>-1015.58</td>
<td>-253.89</td>
<td>-1269.47</td>
</tr>
<tr>
<td>2007</td>
<td>-754.66</td>
<td>1531.31</td>
<td>95.56</td>
<td>-2381.53</td>
<td>-595.38</td>
<td>-2976.91</td>
</tr>
<tr>
<td>2010</td>
<td>651.63</td>
<td>2880.93</td>
<td>174.76</td>
<td>-2404.06</td>
<td>-601.01</td>
<td>-3005.07</td>
</tr>
</tbody>
</table>

政策减少政府的流转税收入：理论上，营业税转变为增值税后，在建筑业中，增值税可减少企业支付的流转税，其额外教育税和城市维护税以及政府的流转税收入。表2和3表明建筑业在2005年时中国建筑业的总产值从34,552.10亿元下降到2010年的96,031.13亿元。这直接导致了2005年增值税取代营业税后流转税的变化从-1015.58亿元下降到2010年的-2404.06亿元。

它增加了下游企业的增值税抵扣税：在建筑业中，纳税人可以使用在商品或劳务采购过程中产生的增值税进行抵扣，减少购买者的增值税，同时使政府的税收入减少了。表3表明，建筑业增值税取代营业税后，抵扣的增值税从2005年的84.58亿元增加到2010年的174.76亿元。

它降低了建筑业企业的所得税：根据表3，建筑业企业的应税收入在增值税取代营业税后有所下降，而应纳所得税亦相应减少。这主要是因为计税标准的改变。值得注意的是，增值税政策的小微企业的优惠政策（应税收入300,000元）也会进一步深入。
All in all, "the replacement of business tax by value-added tax" will inevitably bring about changes in enterprises' tax burden in the construction industry. The fruit of reforms will generally relieve enterprises' tax burdens.

**Analysis of Difficulties in Carrying out "The Replacement of Business Tax by Value-Added Tax" Policy in China's Construction Industry.** The setting of tax rates: The tax rate is an important indicator of the realization of concrete relief of enterprises' tax burdens in the construction industry through "the replacement of business tax by value-added tax". An excessively high tax rate will throw cold water on the enthusiasm of enterprises; while an excessively low tax rate will greatly cut the government's fiscal revenue. An irrational setting of VAT rate will violate the initial intention of reforms and damage the nationwide publicity of "the replacement of business tax by value-added tax" in the construction industry.

The designation of tax payment places: In accordance with the provisions of the current business tax, the tax payment places should be where taxable services take place; the tax liability arising place should be where the agency locates if taxpayer's contracted work covers different provincial administrative regions at the same time. However, considering that the programs in the construction industry are large in size and takes a long time to complete with a strong flow-ability, there are more cross-provincial and subcontracted businesses undertaken by taxpayers. As a result, we need think twice before the designation of tax payment places after "the replacement of business tax by value-added tax" in the construction industry. If the taxable services take place where the tax payment places are, there will be a crying need for the improvement of enterprises' accounting ability. Whereas many of the temporary project department established by construction enterprises are short of sufficient accounting skills [5]. The selection of construction enterprise sites as the tax payment places would make it difficult for the tax authorities to collect taxes and supervise the construction progress and financial situation of projects in another city or region. This will damage the implementation of supervision and regulation works and make it possible for tax evaders to evade taxes.

The deduction of the input tax: At present, the tertiary companies included in VAT pilot programs are so limited while construction enterprises' intermediate costs are not included in the taxable scope of VAT. If "the replacement of business tax by value-added tax" is implemented solely in the construction industry without a deduction chain connecting upstream and downstream enterprises, the tax burdens borne by the construction industry will increase in intensity. Besides, being labor-intensive enterprises, the construction enterprises are confronted with an increasing labor cost in recent years which takes up a large share in their whole costs. But in accordance with the current VAT regulations, the labor cost cannot deduct the input taxes.

The deadline of the deduction of input taxes also brings challenges to the input tax deduction in the construction industry after "the replacement of business tax by value-added tax".

Increasing difficulty in tax authorities' supervision and regulation: The implementation of "the replacement of business tax by value-added tax" in the construction industry of high flow-ability and product complexity would absolutely set higher requirements for various tax authorities' management levels for it is difficult to do cost and profit accounting and strike a balance between different information, which caused more tax evading practices.

**Policy Proposals**

**Prompt Adjustments of the Current Fiscal Distribution System.** At present, business tax and VAT co-exist in China. "The replacement of business tax by value-added tax" in the construction industry will greatly cut the local government's fiscal revenue and redistrict the taxation right of central and local tax authorities. Therefore, to make this reform healthier and run in a more orderly manner, the government should redistrict the taxation right of central and local tax authorities, adjust the interests distribution system of the local government and restructure the ratio at which the tax revenue is shared so as to increase local governments' share of interests and improve the compatible system of fiscal capacity and governance competence in central and local governments.
Proper Designations of VAT Liability Places in the Construction Industry. Tax liability places should still be where the taxable services take place within the project period; Tax liability places should be where the agency locates if taxpayer's contracted work covers different provincial administrative regions at the same time. This will both avoid the emergence of tax evaders and convenience the construction enterprises to do accounting and to supervise their projects' progress and financial situation.

Extend the Pilot Programs of "The Replacement of Business Tax by Value-Added Tax" to More Regions and Industries. At present, the small number of industries within the pilot scope of "the replacement of business tax by value-added tax", the big number of upstream and downstream construction enterprises involved, the great share of labor values of industries excluded by the reform, both input and output labor, as well as the blocked VAT deduction avenue make these tax burdens to be solely borne by construction enterprises, therefore increase enterprises' costs. So, the government should continue extending the pilot programs of "the replacement of business tax by value-added tax" to more regions and industries and strive to open up the VAT deduction chain of upstream and downstream construction enterprises. Only by this way, can the tax burdens be passed on effectively and can the tax reduction effects be achieved in the whole tax system so as to radically promote the healthy and coordinated development of the construction industry.

Strengthen the Regulation of VAT Collection and Improve Management Level. Due to their low management level of finances and businesses, China's construction enterprises are quite inexperienced in terms of VAT invoice management. As a result, the government should adopt measures accordingly to intensify the regulation of VAT collection, to improve the management level and to create a favorable tax payment environment for "the replacement of business tax by value-added tax" in the construction industry. (1) Intensify the management of VAT invoice and the supervision over the exclusive invoices drawn up by tax authorities for small-amount tax payers. (2) Promote the coordination and cooperation between central and local tax authorities so as to further standardize the management of tax collection. Informationalize the tax collection and management system, integrate the operations of central and local tax authorities and promote information sharing; adjust the scopes of responsibility of central and local authorities, share and exchange information on a regular basis; properly promote the integration of the administration of tax service halls of central and local tax authorities so as to lower taxes according to costs and encourage the enthusiasm of legal tax payers.

References


