

## **A Study on the Reform of Personal Income Tax in China**

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**Abstract:** In recent years, personal income tax reform has become a hot topic in China's tax reform. Numerous taxation and levy issues result in increasingly prominent social contradictions, which aroused people's strong desire for reform. Based on the status quo of China's personal income tax, this article will research and analyze China's personal income tax deficiencies. At the same time for its shortcomings, accordingly put forward the future reform of personal income tax ideas.

### **Introduction**

Taxation is the main source of national fiscal revenue, is to achieve the national economic, military and other aspects of the backbone of the building, but also play their own regulation of income distribution function to protect social equity and maintain social stability. Personal income tax is an important part of many taxes. Since the 18th Party Congress, the topic of personal income tax reform has been heating up. March 7, 2017, at the press conference of the Fifth National People's Congress, the Minister of Finance Xiao Jie said that the personal income tax reform program is designing. And he made a statement on personal income tax reform of the relevant ideas, such as the combination of the comprehensive and classified personal income tax system, the increase of the pre-tax deduction of some special projects, and so on, which highlighting the urgency and necessity of personal income tax reform. This article will combine the current situation of personal income tax in China, analyze the problems of personal income tax in China, and construct scientific and rational ideas for the future reform of personal income tax.

### **China's Personal Income Tax Status of the Tax**

#### **Changes in Personal Income Tax Law**

September 1980, China promulgated the "People's Republic of China personal income tax law", the introduction of personal income tax. In order to meet the needs of economic development and people's lives, in 1986, 1993, 1999, 2002, 2005, respectively, the law was five revised and improved. The current "Individual Income Tax Law of the People's Republic of China" divides the taxable income obtained by individuals into 11 tax items and carries out different progressive tax rates and deductions for different tax items. China's personal income tax mainly aimed to individual. The tax collection method includes two kinds: source withholding and personal declaration, so that the collection and payment of personal income tax become more flexible and convenient.

#### **Personal Income Tax System**

China's personal income tax system is a comprehensive classification of income tax system, including the thought of a single tax system, the dual tax system classification framework, and the consolidated income tax system.

Single tax has three significant features: single tax rate, consumption tax base and clean tax base. China's living expenses deduction policy refers to the idea of a single tax rate exemption. And except wages, salary income, individual industrial and commercial household production and operating income, the enterprises and institutions of the contract management, leasing operating income tax, all the tax items are in accordance with the 20% tax rate, to a certain extent, simplifying

the tax rate design.

China's personal income tax source and tax rate design framework embody the dual tax system. In China's current tax system, the labor income includes wages and salaries, labor income and royalties income, but also includes a part of individual industrial and commercial households production and operating income and enterprises and institutions of the contract management, leased operating income. The income of the capital includes the income from the royalties, the income from the lease of the property, the income from the transfer of the property and the interest, dividends and dividends. It also includes the other part of the production and operating income of the individual industrial and commercial households and the contractual operation of the enterprises and institutions. For labor income, except that the tax of labor remuneration and royalties is received in accordance with the proportional tax rate, the rest are in accordance with the progressive tax rate which is accounted for the main part. For the capital gains, except that a part of the production and operation of individual industrial and commercial households and the contracting operation of enterprises and institutions, the income from the leased operating income are received in accordance with the accumulated portion, the rest are levied at the rate. It can be seen that the design of personal income tax source and tax rate in China generally refers to the dual tax system. Although the calculation of the taxable amount of different tax items is not exactly the same, but without considering the tax incentives and special policies, the same taxable amount of taxable income can be summed up, to a certain extent, which reflects the comprehensive personal tax system.

### **The Status of Personal Income Tax Income**

The Ministry of Finance data show that in 2012 China's personal income tax revenue of 582.224 billion yuan, accounted for 5.8% of the total revenue in the tax, occupies an important position in the country to raise fiscal revenue. In addition, wages and salaries occupy the main position in China's personal income tax income. In 2013, the proportion of income tax from wages and salaries accounted for 62.7% of total personal income tax revenue [1]. Wage and salary income has a nonnegligible role on the adjustment of country's income. Most of the low-income earners do not have to pay taxes and tax is transferring to high-income class. Since the increase in the cost of deductions in 2011, the number of taxpayers has been reduced from 84 million to 24 million, and the function of income redistribution has been better understood. In addition, a large number of tax incentives can also reduce the burden of the corresponding industry to some extent, and promote its rapid development.

### **China's Personal Income Tax Problems**

#### **There Are Too Many Taxonomies and the Tax Burden is Unfair**

China's personal income tax system is not a comprehensive income tax system, but includes too many tax items. Too detailed tax items and different taxation standards not only affect the fairness of the tax, but also increase the cost of tax work, reducing tax efficiency. Take the wages, salary income and labor remuneration under the dual tax system as an example. Assuming that A all income sources are only wages, salaries and labor remuneration and his monthly income is 3,500 yuan, he should pay the personal income tax for Party A is zero; And B due to the labor remuneration tax, the income of 4,000 yuan in the following 800 yuan deduction, so he need to pay personal income tax  $(3500-800) \times 20\% = 540$  yuan, that B net income of 2960 yuan. Compared with A, the tax burden of B is larger. Especially when the living standard of B is lower than that of A, the tax burden will increase the living pressure of B, which is unfair to B. This also shows that the different income tax within the similar income standards will affect the tax fair, not fully consider the true burden of taxpayers. Especially in the case of rising economic crisis unemployment rate, labor income may become the main source of income for the unemployed, so designing tax rates should also consider the actual social situation.

In addition, the tax items are too detailed to increase the cost of collection. In terms of labor

income, although most of the tax is in withholding, the varied classification calculation and management not only will increase the human source input, but also increase the taxpayer's compliance costs, reducing tax efficiency.

### **Tax Payment in Personal Unit, Ignoring the Actual Burden of Taxpayers**

The main body of personal income tax is mainly in the individual, which is beneficial to simplify the tax calculation and taxation cost, and realize the tax fairness in the theoretical sense. But people are the main body of social relations, to some extent there is the obligation of others or interdependent social relations, such as the maintenance of parents, raising children. The burden of the different taxpayers is different, but it is likely to achieve the same income. For example, in the state-owned enterprises to work, Wang made 4800 yuan before the wage tax, with the need to bear the two parents of the maintenance obligations, the two children raising and sick wife to take care. And all of them except him have no income, so Wang need to bear 6 people obligation. Wang's colleague Lee monthly salary is also 4800 yuan, and his family income situation is that parents are high-income earners, his wife has a source of income, and he has no children. Compared to Lee, Wang needs to pay the same personal income tax under heavier burden of Wang's family. If we do not consider the individual's actual family tax burden, it is likely to lead to real income gap and social inequality growing.

### **Ignoring the Social Problems Brought by Inflation and Other Factors**

The law has the characteristics of stability, which cannot move toward the evening. Tax law is also true. In the case of inflation, prices continue to rise, but the nominal income will rise simultaneously. If the tax authorities do not deduct the inflation factor, only according to the nominal income to determine the tax burden, it is possible to push the taxpayer into a higher tax rate [2], which increases the actual tax. "China Pay White Paper for 2015", recently released by Human Resources Research Institute Zhongda Parkson Research Institute, shows that China's overall pay increase of 7.4% in 2015, and according to the China National Bureau of Statistics released data, China's inflation rate in 2015 was 1.4 %. So the actual growth is 6% by a rough calculation of China's wages in 2015. For example, only having wages, salary income, Wang's average monthly income in 2014 is 3300 yuan, by the nominal salary growth rate of 7.4%, the average monthly income in 2015 to 3544.2 yuan. So Wang need to pay taxes  $(3544.2 - 3500) \times 3\% = 1.326$  yuan of personal income tax. After deducting the influence of the inflation, by the actual salary growth rate of 6% in 2015, the actual average monthly income of 2015 is to 3498 yuan, less than 3,500 yuan of the cost of deduction standard, so no tax has to be paid. As can be seen from the above example, considering the inflation factor will reduce the actual tax burden, will make the tax burden more reflect the level of social development. If we do not consider the actual tax burden, it will increase the burden on people's lives, inhibit consumption, and make the social and economic downturn.

### **All Kinds of Illegal "Tax Avoidance" Means Are Endless**

The Law of the People's Republic of China on Tax Collection and Administration regulates the tax collection of tax authorities and the punishment of taxpayers', strengthening of tax regulations. But in practice, the regulatory are not very efficiency. For example, invoicing reimbursement not only increases the deducting project of the enterprise before taxes, reduces the payment of the enterprise income tax, but also declines individuals' income declaration to pay less tax. This reduces the country's fiscal revenue and damages the interests of the country. Therefore, the state in the invoice supervision and tax supervision, to a certain extent, does not provide enough protection for the operation of the tax collection.

### **Excessive Tax Incentives Make Regulatory Costs Increase**

Tax incentives are an important aspect of tax policy. According to the relevant laws and regulations, the personal income tax preferential policies are divided into three categories: regulated by the "personal income tax law"; the enjoyment of tax cuts after approving; temporary tax incentives items regulated by the Ministry of Finance or State Administration of Taxation. Tax incentives are

mainly aimed to low- and middle-income earners, soldiers and disaster -affected areas, as well as investment and so on. Overall, more preferential tax policies lead to a certain degree of unfair. For example, according to the Ministry of Finance, foreign individuals' dividends that are obtained from foreign-invested enterprises is the temporary exemption. However, compared with it, residents' dividends have no temporary exemption. Although obtaining dividends from the listed company also has the corresponding preferential provisions, it fundamentally doesn't not solve the problem of tax unfairness of Chinese and foreign people. Moreover, excessive tax incentives not only will increase the number of tax evasion, but also increase the cost of tax regulation.

In general, China's personal income tax is a comprehensive classification system. China's personal income tax was levied later than foreign country. Although experiencing many reforms, compared with foreign developed countries, China's personal income tax is immature and needs to be reformed again.

## **Ideas of Improving China's Personal Income Tax Reform**

### **China's Personal Income Tax Reform Direction**

To reform the personal income tax system, China must give priority to efficiency with due consideration to fairness. Government should take full account of the actual situation of our society, and make personal income tax actively play the important role in income distribution, social equity and economic regulation [3]. China's tax reform direction should be: "single tax" thinking, "dual tax" framework, further integrated system. "Single tax" thinking includes 3 points: to further harmonize the tax rate, to approach tax neutral, and to clean tax base. This is important for reducing tax costs, improving tax efficiency and fairness. In addition, although China's tax source classification framework for the "dual system", the above has been analyzed that labor income tax project is not uniform, which not only increases tax collection costs, but also makes the tax unfair phenomenon serious. In this regard, China's income tax system can learn from the idea of a single tax system that labor income tax project can use the consolidated income tax rate. In this way, on the one hand it can measure the actual tax burden of taxpayers. When people make their labor remuneration and wage income gather to deduct a certain deduction standard, you can truly measure the actual income of individuals. On the other hand, it can eliminate the unfairness of the tax burden of different tax items, such as wages, salary income and labor remuneration.

For capital gains, the use of a single tax rate is still classified because the capital gains are mostly due to the profit generated by the assets. Compared to labor income the capital gains are a greater chance. So the uniform tax rate can maintain the fairness of the tax burden of capital gains.

The advantages of using a comprehensive progressive tax system within the labor income exist, but there are some difficulties in terms of technical and practical aspects. At the technical level, if the comprehensive and progressive tax system is adopted, it is necessary for the state to establish a tax database for the individual, and the taxpayer's tax data will be transferred to the database when the tax is deducted, which requires high-tech support and speed up the development of such a database system to achieve a comprehensive system. At the actual level of operation, the taxpayers shall first establish the withholding and prepayment system. Specifically, when the taxpayers obtain the taxable income in different units or from different sources (for example), each enterprise shall withhold personal income tax at the withholding rate respectively and put taxpayers' tax data into the database system. It is year-end final settlement, more refunds less makeups. Secondly, tax authorities should strengthen the enterprise withholding behavior norms and increase the intensity of punishment, so that enterprises consciously abide by withholding obligations. Finally, to improve the taxpayer's tax awareness, combining self-declaration system with withholding system is conducive to tax collection and payment, which can achieve national interests and personal interests of the win-win situation.

### **To Declare Tax in the Family As A Unit**

To declare tax in the family as a unit is to take "family declaration system". "Family declaration

system" in the United States uses a wide range. This tax system can measure the real burden of taxpayers to reduce the influence of the family population factors on the taxpayer's actual tax burden. Based on the family population, by the merger of family income, the more the population, the more income you can deduct. This method should be based on the household registration system and should consider both the number of the family member and household income. Therefore, the perfect household registration system is precondition of "family declaration system". In addition, the development of advanced family tax database system, is the technical conditions of the use of "family declaration system". Furthermore, seamlessly docking the household registration database system and family tax database system is the important guarantee of using "Family Declaring System".

### **The Tax Index Adjusts the Nominal Tax to Calculate the Actual Tax Burden**

Tax index is aimed to eliminate the rise in the grade of the tax rate resulting from the increase in nominal income due to inflation. For a part of low-income earners, they actually are not required to pay personal income tax in accordance with the tax law. But the nominal income increasing will make them pay the corresponding tax burden, increasing the burden of low-income people. In the 1980s, some industrialized countries began to use tax indexing measures, that is, by way of law to adjust the tax rate table. According to this revelation, it is possible to reduce the tax burden of the taxpayer due to the inflation factor, which can increase the credibility of the government and better reflect the thought of the government's service to the people.

### **Strengthening the Supervision of Invoices and Increasing the Intensity of Illegal Tax Evasion**

Increasing the supervision of invoices is an important measure to prevent tax evasion. To strengthen the supervision and inspection of enterprises, invoice inspection and internal control system should be the focus of supervision. At the same time, the illegal invoices and illegal reimbursement of punishment should be increased, and the punishment of illegal tax evasion should be strengthened, thus reducing or even curb tax evasion [4]. At the same time, tax authorities at all levels should strengthen the supervision of personal income tax, timely supervision and feedback of personal income tax collection to recover the arrears and to pursue the legal liability according to the law.

### **Reducing Tax Incentives to Promote Social Equity**

Tax incentives can really stimulate the development of preferential subjects, but increase the cost of tax collection and management. Excessive tax incentives are a waste of human and material resources, and are not conducive to tax fairness. Therefore, reducing tax incentives, including reducing the gap between Chinese and foreign tax policy, has an important role in promoting domestic economy. Driving the country's economic growth cannot be overly dependent on foreign enterprises, but should play the role of local enterprises. "Public entrepreneurship, innovation" should be the mainstream of society. In addition, tax incentives to low-income earners or special people (such as people with disabilities), will be conducive to play the role of income redistribution, which is of great significance for improving social equity.

### **Conclusion**

Based on the current situation of personal income tax in China, this paper analyzes the existing problems of personal income tax in China, and puts forward some suggestions on how to improve the personal income tax in China. In general, China's personal income tax reform direction should be "single tax" thinking, "dual tax" framework, to achieve further comprehensive system. In this framework, further improving the personal income tax levy policy will promote tax fairness and improve tax efficiency.

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