

Review and Future Prospect of Value-added Tax Reform Against the Background of Taxes and Administrative Fees Reduction

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Abstract—Taxes and administrative fees reduction is a major decision by the CPC Central Committee and the State Council to deepen supply-side structural reform, and a strategic measure to promote high-quality development. China's value-added tax (VAT) reform has been changing with the development of economy. The advent of the digital economy and cross-border transactions has also posed challenges to the traditional VAT system.

Keywords—VAT; reform; challenge

I. INTRODUCTION

Cutting taxes and administrative fees reduction is an important decision by the CPC central committee and the State Council to deepen supply-side structural reform, and a strategic measure to promote high-quality development. In 2019, China will continue to deepen the reform of the tax and fee system, and build a central and local income distribution pattern dominated by sharing taxes. One of the measures is to deepen the VAT reform so as to build a more concise, neutral and fair VAT system. VAT is currently the most commonly used indirect tax in the world (KPMG, 2015), which is also the largest tax in China. Because its taxation basis is the added value of a commodity in circulation, it involves a wide range of groups and almost all units and individuals are VAT taxpayers. VAT is emphasized and adopted by most countries in the world for its advantages of tax neutrality and strong revenue function, etc. This paper analyzes the process of China's VAT reform and compares it with the international VAT reform to predict the future direction of VAT reform and implementation points. The rapid development of Internet technology has given birth to and affected every field of social and economic life, forming a new form of digital economy. The digital economy will bring new challenges and pressure to the current tax system and the tax collection and management system, mode, mechanism and mode. Cross-border trade in goods and services, especially intangible assets, has brought challenges to the traditional VAT system.

II. CHINA'S VAT REFORM PROCESS ANALYSIS

Professor Adams of Yale University first proposed the concept of value-added tax in *Business Tax* in 1917. The original intention of proposing this concept is to overcome the obvious defects of business tax and avoid double taxation. In 1954, France actively promoted the development and implementation of value-added tax system, and achieved success. The evolution of China's tax system is a process of constant simplification. After the founding of the People's Republic of China, in January 1950, the Government Administration Council of the People's Republic of China promulgated the "Key Rules of National Tax and Administration Implementation", which was formulated in the spirit of "ensuring the supply of revolutionary wars, taking into account the needs of the recovery and development of production and national construction, simplifying the tax system, and carrying out reasonable burdens". It was determined that there were 14 types of taxation nationwide, and tax revenue did not constitute the main source of national fiscal revenue. In 1978, as the Third Plenary Session of the Eleventh Central Committee of the Communist Party of China (CPC) kicked off the reform and opening up, the tax system reform also started in the market orientation reform exploration. In order to meet the needs of opening to the outside world and introducing foreign capital, foreign tax system became the breakthrough point of tax reform in the new period. The "Income Tax Law on Sino-foreign Joint Ventures", the "Individual Income Tax Law", and the "Income Tax Law on Foreign Enterprises" were enacted successively, playing an important role in attracting foreign direct investment and developing foreign economic and technological cooperation. At the same time, with the foreign tax system as the starting point, the domestic tax system has also taken steps following the reform of the market economy.

A. The Legislation Stage of VAT in China

In 1979, the feasibility of levying VAT was investigated in China. In 1980, pilot projects to collect value-added tax were first carried out in the machine and machinery industry in Liuzhou of Guangxi and Shanghai. In 1981, the scope of

the pilot projects was extended to bicycles, electric fans and sewing machines. In 1983, the value-added tax was expanded to the whole nation. In 1984, the State Council Promulgated the "Interim Regulations of the People's Republic of China on Value-added Tax (Draft)". The VAT rate at that stage was too high, and the tax range did not include all products and all links. So it was only the introduction of the VAT method, not the VAT in the real sense. The domestic tax system began to learn from the advanced experience of foreign tax systems and initiated the reform from the planned economy tax system to the market economy tax system. Starting from January 1, 1983, the State Council decided to carry out a nationwide trial of the "Tax for Profits" among state-owned enterprises, replacing the profits paid to the state by state-owned enterprises with enterprise income tax. On September 18, 1984, the State Council approved the "Report on the Implementation of the Second Step of the Tax Reform in State-owned Enterprises" and the "Trial Measures for the Second Step of Tax Reform in State-owned Enterprises" of the Ministry of Finance, starting to implement the second step of "Tax for Profits", laying the foundation for the comprehensive implementation of industrial and commercial tax reform in China. A relatively complete tax system has been put in place for domestic and foreign-funded enterprises, with turnover tax and income tax as the main body and other taxes in line with each other.

After the 14th national congress of the communist party of China (CPC) held in 1992, the financial and tax departments began to accelerate the process of deepening the reform of tax system. The "Interim Regulations on Value-added Tax (VAT)" issued on December 13, 1993, stipulates that from January 1, 1994, VAT shall be levied on the sale of goods, processing, repair and replacement services and import of goods. Based on the need of controlling investment scale, guiding investment direction and adjusting investment structure, the general taxpayer was not allowed to deduct the input tax of fixed assets. So it is called "production-oriented value-added tax". And the tax on machinery and equipment was included in the cost and could not be deducted, which was not conducive to encouraging enterprises to carry out technological transformation and contradicted the policy of encouraging enterprises to improve their technological level and increase the content of science and technology in China.

B. Transition Stage of VAT in China

With the establishment and gradual development of China's market economy, the problems caused by production-oriented value-added tax became increasingly prominent. No matter from the standardizing value-added tax system and adapting to the global economic integration or from the promotion of domestic enterprises equipment investment and technological upgrading, VAT transformation was imperative. In 2004, China began to implement the transformation from production-oriented value-added tax to consumption-oriented value-added tax in pilot projects. Since July 1, 2004, Liaoning province, Jilin province, Heilongjiang province and Dalian city in northeast China have implemented the pilot policy of expanding the

scope of VAT deduction, shifting from production-type VAT to consumption-type VAT. In November 2008, the State Council promulgated the newly revised "Interim Regulations on Value-added Tax", and decided to implement the VAT reform nationwide from January 1, 2009. It stipulated that input tax on fixed assets (excluding cars) could be fully deducted.

C. The Scale Enlarging Stage of Replacing Business Tax with VAT

On November 16, 2011, the Ministry of Finance and the State Taxation Administration have issued the "Pilot Plan for Replacing Business Tax with Value-added Tax" approved by the State Council, and at the same time the "Measures for the Trial Implementation of Replacing Business Tax with Value-added Tax in the Transportation Industry and Some Modern Service Industries", "Provisions on the Pilot Projects to Replace Business Tax with Value-added Tax in the Transportation Industry and Some Modern Service Industries" and "Provisions for the Pilot Transitional Policy of Replacing Business Tax with Value-added Tax in the Transportation Industry and Some Modern Service Industries", specifying that from January 1, 2012, the pilot project of replacing business tax with value-added tax in the transportation industry and some modern service industries in Shanghai would be carried out. Shanghai's reform has greatly promoted the reform of replacing business tax with value-added tax. The reform scope was then enlarged to Beijing, Tianjin, Jiangsu, Anhui, Zhejiang (including Ningbo), Fujian (including Xiamen), Hubei, Guangdong (including Shenzhen), which have been included in the pilot areas of replacing business tax with value-added tax since September 1, 2012. Since May 1, 2016, the pilot project to replace business tax with value-added tax (hereinafter referred to as replacing business tax with VAT) has been implemented nationwide. All business tax payers in the construction, real estate, financial and life service industries were included in the pilot program and began to pay VAT instead of business tax. On November 19, 2017, the "Decision of the State Council on Abolishing the 'Interim Regulations of the People's Republic of China on Business Tax' and revising the 'Interim Regulations of the People's Republic of China on Value-added Tax'" was announced, marking the end of business tax and the completion of replacing business tax with VAT. This reform is another major reform of the tax system on goods and services after the full implementation of the VAT transformation in 2009. It is also an important structural tax reduction measure, which eliminates the problem of double taxation caused by the separate collection of value-added tax and business tax on goods and services.

D. Stage of Further Deepening the VAT Reform in China

The VAT reform which began in 2017 focused on tax cuts and tax cuts. In the 2018 government work report, it is proposed to "reform and improve the value-added tax system, adjust tax rates in the direction of merging the three brackets into two, focus on reducing the tax rates of manufacturing, transportation and other industries, and raising the standard of annual sales of small-scale taxpayers". In the 2019

government work report, it is proposed to "deepen the VAT reform, reduce the current rate of 16% to 13% in manufacturing and other industries, and reduce the current rate of 10% to 9% in transportation, construction and other industries, to ensure that the tax burden of major industries is significantly reduced; keep the first grade tax rate of 6% unchanged, but ensure that the tax burden of all industries will only be reduced and not increased by adopting supporting measures such as increasing tax credit for the production and living services, and continue to move toward the direction of promoting the merging the three brackets into two, and simplifying the tax system.

The VAT reform is an important decision made by the Chinese government to comprehensively grasp the international and domestic economic development situation, focus on building a modern economic system, deepen supply-side structural reform and improve the business environment. It has taken another big step towards the goal of building a high-quality value-added tax system, which follows the design principles of neutrality, efficiency, fairness and simplicity advocated by OECD. This is not only in line with the international VAT system, but also reflects China's responsibility as a member of OECD VAT BBS. A senior assessment report of OECD once pointed out that "China has achieved remarkable results in the design and operation of the VAT system in a very short period of time". Efforts are needed to further consolidate and expand the results of replacing business tax with VAT and continue to improve policies.

III. PROBLEMS WITH THE VAT SYSTEM

China's value-added tax has been improved to a large extent, but the system of value-added tax has not been fully

mature and finalized, and there are still many problems to be improved in the implementation process.

A. Problems of VAT System

The VAT system can be generally divided into modern and traditional types. The modern VAT system is represented by New Zealand, Australia, Canada and other countries, featuring flat tax rate. China is a developing country mainly adopting value-added tax, rather than a developed country that adopts income tax mainly. It adopts the traditional value-added tax system and the tax rate structure is generally the standard rate plus some grades of lower tax rates. Therefore, the level of standard tax rate can reflect the level of VAT rate to some extent. China's VAT rate has undergone five changes, as shown in "Fig. 1" and "Fig. 2" below:

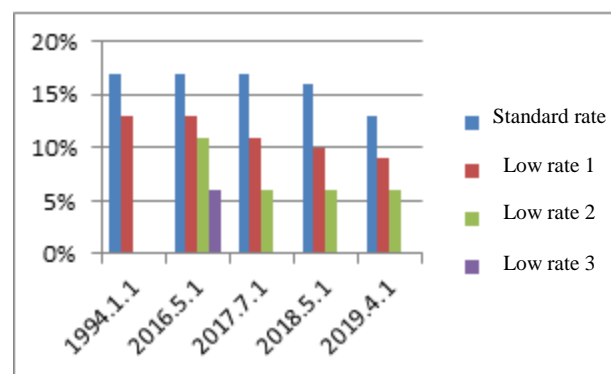


Fig. 1. China's VAT rates and number of grades.

^a Data source: website of the State Taxation Administration (the zero tax rate is not included).

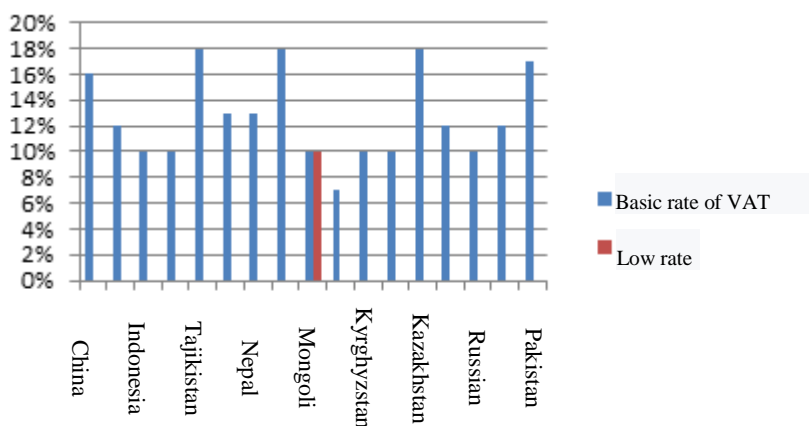


Fig. 2. The standard rate of value-added tax in China and neighboring countries.

Since 1994 China has maintained a basic rate of 17%, with a lower rate of 13%. Since 2012, its VAT reform has been comprehensively accelerated. By May 2016, business tax was entirely replaced by value-added tax. This reform has completely broken through the deduction chain between the manufacturing industry and the service industry. On May 1, 2016, the pilot project of replacing business tax with VAT

was carried out comprehensively, with two additional grades of low tax rates for some industries: 11% and 6%. In April 2017, the Ministry of Finance and the State Taxation Administration issued the "Notice on the Policy of Simplifying the VAT Rate", abolishing the 13% tax rate, in order to cope with the international competition of tax reduction and maintain the steady growth of the domestic

^a Data source: Global Taxation Systems: Status & Trends.

economy. On July 1, 2017, all goods subject to the 13% tax rate began to be bracketed in the rate grade of 11%. The State Taxation Administration of the Ministry of Finance has issued the "Notice on Adjustment of VAT Rate", stipulating that the originally applicable tax rates of 17% and 11% shall be adjusted to 16% and 10% respectively. "Notice on Policies for Deepening VAT Reform" jointly issued by the Ministry of Finance, the State Taxation Administration and the Central Administration of Customs on April 1, 2019 (hereinafter referred to as the notice), stipulates that from April 1, for general VAT taxpayers who have engaged in VAT taxable sales or imported goods, the original applicable tax rate of 16% will be adjusted to 13% and 10% to 9%. After the reform, the tax rate is still complicated, with three basic tax rates, as well as zero tax rate and tax rate for small-scale taxpayers. Compared with neighboring countries, if the problem of multiple VAT rates cannot be solved, the reform goal will be greatly compromised. And the reform of simplified VAT rate needs to be deepened urgently.

B. Problems in VAT Legislation

The Chinese government has been taking VAT as an important tool to adjust the economy. The current interim regulations on value-added tax and the pilot policy of replacing the business tax with a VAT are still at the level of administrative regulations and have not been incorporated into the legal framework, which is not conducive to the realization of the principle of law-based taxation. Tax legislation should lead the tax reform and combine the forward-looking VAT legislation with the reform stage. And it's necessary to do a good job in the top-level design, solve the VAT legislation reform specific ideas and discuss further implementation plan.

C. Problems in the Collection and Management of VAT in Digital Economy

The 2017 government work report once again called for further development of "Internet plus" and included "digital economy" in the government work report for the first time, specifying the requirements for accelerating the growth of the digital economy. Many transactions in the digital economy involve individual customers, who do not need vouchers to offset their expenses before pre-tax and itemized deduction, and therefore do not require invoices. This largely limits the scope of the invoice system, which is the core of China's tax collection and management. Under the background of economic globalization, cross-border digital economy has increasingly become an important part of the economic and trade exchanges among countries. Cross-border trade in goods and services, intangible assets in particular, poses challenges to the traditional VAT system, especially when consumers buy goods from abroad. Different from the real economy, the cross-border digital economy based on network virtual platform has formed a severe test to the traditional tax system and tax collection and management. The traditional tax system, tax rules and tax regulation model have been unable to adapt and cope with the new situation to some extent. Due to the absence and incoordination of value-added tax (VAT) systems for cross-border digital transactions, the problem of double taxation

and unintentional non-taxation of cross-border digital transactions has become increasingly prominent.

IV. FUTURE DIRECTION AND PROSPECT OF VAT REFORM

A. In the Future, VAT Reform Will Focus on Lowering the Tax Rates and Simplifying the Grades of VAT

VAT has the advantages of tax neutrality and high transparency. Since it was first introduced in France in 1954, VAT has been gradually promoted worldwide. At present, about 170 countries (regions) have introduced tax, and the related reform has become the focus of the world tax reform. The more grades the VAT rates have and the more complex the system is, the higher the compliance costs for taxpayers and the administrative costs for tax authorities will be. The greater the difference between different tax rates is, the stronger the desire of taxpayers to apply low tax rate will be, and they will be more prone to the "wrong" application of low tax rate, which will affect the efficiency of the VAT system. It is necessary to optimize and adjust the tax structure, form a balanced distribution of direct tax and indirect tax, and reduce or even reverse the regressive nature of the overall tax system. VAT should be coordinated with other reforms, especially direct tax reform. It is needed to increase the proportion of direct taxes such as personal income tax and real estate taxes to make room for the reform of simplifying value-added tax rates and reducing the proportion of value-added tax.

B. Challenges Brought by Digital Economy to the Collection and Management of VAT in Cross-border Service Trade

The new changes of national taxation under the digital economy have been highly concerned by the major countries in the world. The business models of digital economy mainly include e-commerce, various app stores, online advertising, cloud computing, fast trade, participatory online platform, online payment service, etc. These economic models are also the main objects for countries around the world to study and formulate tax rules. According to trading entities, e-commerce models can be divided into Business to Business (B2B) Model, Business to Customer (B2C) Model, and Consumer to Consumer (C2C) Model. Among them, the B2C online cross-border trade in services trade is the most difficult and complex mode for VAT collection and management, because there is no physical logistics form, and it is difficult for customs to implement effective border control. From the construction of tax rules of digital economy, countries around the world are responding positively. Currently, about 50 countries are preparing unilateral plans to deal with the digital economy. However, unilateral measures are not conducive to coordination among countries and will increase the tax burden of enterprises in the digital economy, which is contrary to international tax governance goals. The tax collection and management problems incurred by digital economy may be caused by the coexistence of different tax systems. Therefore, it is suggested that the taxation of digital economy should be discussed in the future under the framework of giving

consideration to direct taxation and indirect taxation. The receiving party should be designated as the tax agent of the service provider, and the receiving party should pay VAT to the tax authorities of the importing country on behalf of the overseas taxable service provider in the capacity of legal agent. In this way, the normalization of VAT system and the convenience and effectiveness of VAT collection and management can be combined.

V. CONCLUSION

VAT reform will basically continue to strengthen its revenue function on the premise of simplifying tax rates, broadening the tax base and maintaining "neutrality". Simplified tax system, strict mechanism, the lowest degree of economic distortion, the lowest tax collection and payment cost, easy management and many other goals will become the further development direction of the value-added tax system in the world.

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