

Thoughts and Analysis on the Reform of New Personal Income Tax*

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Abstract—On August 31, 2018, China realized the seventh amendment of personal income tax. Taking the introduction of the background and necessity of the reform of personal income tax as the starting point, this paper briefly expounds the relevant policy points before and after the new tax reform, the advantages and disadvantages after the tax reform, and draws lessons from relevant policies in some foreign countries, puts forward some suggestions on optimizing the personal income tax in China, in order to effectively improve and perfect the laws and regulations of personal income tax in China and realize the tax collection. Realizing a modernized, rational and scientific tax collection and supervision system and tax administration concept is conducive to achieving fair tax burden.

Keywords—personal income tax; comprehensive taxation; special additional deduction; reform

I. INTRODUCTION

At present, personal income tax, just next to value-added tax and corporate income tax, is the third largest tax in China. Before the personal income tax reform in 2018, this tax was levied by classification, with low threshold, as per different tax rate and deduction standard for different source of income, and did not consider the differences caused in regions having different economic development levels and the actual economic income of the taxpayer, so that the tax failed to effectively play its role in regulating income and realizing social justice. On August 31, 2018, the fifth session of the standing committee of the 13th National People's Congress voted for and approved the "Decision on Amending the Personal Income Tax Law of the People's Republic of China" which is the seventh amendment to personal income tax law of China since 1980. The tax reform was carried out in stages. Stage one (from Oct.1, 2018 to Dec.31, 2018) was to increase the threshold and adjust and optimize the tax rate structure; the tax threshold was uniformly increased to 5,000 Yuan/month; and the level of low-grade tax rate and quick calculation deduction were expanded; the taxable amount is calculated according to the new table of 3%-45% level 7 excess progressive tax rate. Stage two (from Jan.1, 2019 on) was to put into all-round implementation of some new tax systems such as annual

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comprehensive declaration and special additional deduction. Wage, salary, labor remuneration, author's remuneration and royalty were subject to comprehensive collection of personal income tax in the tax year; moreover, six special deduction items such as children's education and support for the elderly were added. In short, the idea of this personal income tax reform is to implement a comprehension and classification combined taxation system, raise the threshold for personal income taxation, adjust the tax rate structure, and add six special deduction items and other highlights.

Since China began to levy personal income tax in 1980, the classified taxation system has always been adopted due to the single income source of the taxpayer. However, with the rapid economic development in China and even the world, industries are in diversified development trend so that residents' income sources are no longer limited to wage and salary incomes. In this context, if the classified taxation system is still applied, high-income taxpayer may avoid taxation by breaking down his/her income by virtue of taxation loopholes. Thereby, it is imperative to reform the taxation method by combining personal income classified taxation and comprehensive taxation.

II. ANALYSIS OF THE CHARACTERISTICS OF PERSONAL INCOME TAX BEFORE AND AFTER THE REFORM

A. Characteristics of Personal Income Tax Before the Reform

1) *Classified income tax system was implemented:* Before the reform, classified income tax system was implemented, namely personal incomes were divided into 11 types such as income from wage and salary, individual business's income from production and operation, and income from labor compensation; each type was taxed by different deduction criteria, different tax rate and different tax calculation method. However, with the diversification of residents' incomes, the drawbacks of classified taxation system were becoming more and more obvious. Especially, high-income groups with many income channels often avoided taxation by breaking down the incomes and deducting for multiple times; in contrast, those who have concentrated income sources needed to bear high tax burden;

in this way, it was hard for taxation to play a fair and reasonable role.

2) *Two types of tax rates such as excess progressive tax rate and proportional tax rate were applied:* Personal income tax, by the nature of income, was applicable to different tax rate. The calculation of proportional tax rate was simple and convenient, and was beneficial to tax withholding at the source, while excess progressive tax rate could better regulate the income and reflect the fairness of tax burden. From the actual situation, China's excess progressive tax rate design is not scientific enough, mainly because there are too many levels. In the international general practice, only about 3 levels are set, while in China there are 7 levels; however in practice, most taxpayers are only subject to the tax rate of 5%-20% and it is of no sense to set the tax rate above 25%.

3) *Different fee deduction forms were applied:* Before the reform, personal income tax by the nature of income had different tax deduction forms which mainly included four types of deductions such as quota deduction and fixed rate deduction. Quota deduction criteria was adopted no matter in which form of deduction; this way completely ignored the differences in economic development levels of various regions of China, and the economic income status and population of the taxpayer's family; hence, it was bound to get the middle- and low-income groups who have heavy family burdens overburdened. In this way, there was no way to play the positive role of taxation in regulating income distribution and create a harmonious society.

B. Characteristics of Personal Income Tax After the Reform

1) *Partial labor incomes were subject to comprehensive taxation:* The incomes under comprehensive taxation in this reform include wage, salary income, income from labor remuneration, income from author's remuneration and royalties. For comprehensive income, the personal income tax is calculated by year, withheld or paid previously by the taxpayer by month or time, and uniformly settled at the end of the year for supplement or refund.

2) *The tax rate structure is optimized and adjusted:* After the reform, the tax rate structure for comprehensive income taxation is still a 7-level tax rate structure, but the tax rate difference between different levels is adjusted. The current income tax rate at 10% is reduced to 3%, and the current income tax rates at 25% and 20% are both reduced to 10%; the interval of tax rate at 10% is significantly expanded. After this adjustment, low- and middle-income groups can enjoy the treatment of lowering the first-class tax rate so as to rationally and effectively reduce their tax burden.

3) *The scope of deduction is expanded:* In calculating a taxpayer's comprehensive income, the deductions are divided into four categories: basic expense, special deduction, special additional deduction, and other deduction. The criterion of basic expense is raised from the original 3,500 Yuan/month

to 5,000 Yuan/month. The special deduction includes: the "three insurances (endowment insurance, medical insurance and unemployment insurance) and one fund (housing provident fund)" to be paid in accordance with the scope and criteria specified by the state. Special additional deduction include: six aspects of expenses such as child education, continuing education, major illness medical care, housing loan interest, housing rent, and support for the elderly. At the same time, anti-tax avoidance provisions are added specially for dealing with taxpayers' unreasonable tax avoidance behavior.

III. ADVANTAGES AND SHORTCOMINGS IN THE REFORM

A. Advantages

This reform mainly has the following three advantages. First, it implements a comprehensive and classified taxation system; compared with the previous simple classified taxation system, this combined taxation system can better reflect the fairness and reasonableness of tax system. Second, it raises the taxation threshold and expands the taxation interval; this way effectively reduces the tax burden of low- and middle-income groups, stimulates the consumption of low- and middle-income people, and improved their living quality. Third, it adds six special additional deductions; this way takes into account the differences in taxpayers' ability to bear the tax, effectively reduces the tax burden of taxpayers and promotes the vertically fair development of taxation.

B. Shortcomings

1) *Unreasonable deduction criteria:* From the perspective of meeting basic living needs, for Beijing, Shanghai, Guangzhou, Shenzhen and other first-tier cities, the threshold of deduction from 5,000 Yuan/month is obviously not in correspondence with the level of price development there; six special deductions are added, and the deduction criteria of 1,000 Yuan/month is defined; however, there is still lack of a systematic and comprehensive consideration of many factors such as the differences in regional economic development, and the differences in the expenses of children's education. Therefore after the reform, personal income tax loses the initial fairness and rationality of taxation in certain areas.

2) *High top marginal income tax:* When determining the tax rate level, it is necessary to take into consideration the international competition of taxation and appropriately consider the tax rate levels of neighboring countries. According to the "Global Taxation Systems: Status & Trends (2016)" compiled by the State Taxation Administration, the highest personal income tax rate is 50% in Japan, 41.8% in South Korea, 33% in India, 30% in Indonesia, 35% in Pakistan, and 32% in the Philippines, 35% in Thailand and Vietnam, and 30% in Russia. Compared with neighboring countries, the highest rate of personal income tax in China is 45% which is a bit high.

3) *Inapplicable mode of tax withholding*: In China, personal income tax is mainly collected by means of withholding by employer of the taxpayer or independent declaration by the taxpayer him/herself, wherein the former mode is often adopted. After this reform, comprehensive and classified taxation system is implemented. For taxpayers having multiple income sources, their tax may be only calculated and withheld on the basis of their income from one company, and it is easy to ignore their incomes acquired from other company, resulting in repeated deductions or low applicability of current tax rates.

IV. THE CHARACTERISTICS OF PERSONAL INCOME TAX IN SOME FOREIGN COUNTRIES

A. *Personal Income Tax System in the USA*

Personal income tax is an important financial source of US government. From US president to civilian population, taxation becomes the duty and responsibility of everyone. In the USA, this tax rate is increased gradually in accordance with personal income so as to reduce the tax burden of low-income groups and control the excessive income increase of high-income groups. The most basic principle is to have those having many incomes and high income pay more tax and have those having low income pay tax first and rebate them later. First, the taxation for personal income in the USA may take into consideration the income of a person and the quantity of the person's family members. Second, high-income groups are the main bodies of personal income taxation in the United States. Personal tax declaration system is adopted by Americans for paying tax; and the April 15 of each year is the deadline for Americans to declare their incomes and taxation status in the previous year. Before the declaration, they can collect a form or use computer to declare their actual incomes to the government.

B. *Personal Income Tax System in Australia*

In Australia, every taxpayer has a tax number. Taxpayer must submit his/her tax number to a bank or employer when making investment or being employed. If the taxpayer fails to submit the tax number, the employer or bank will withhold corresponding tax according to the law at the highest personal tax rate when paying him/her wage or interest. In this case, the taxpayer must make application in order to get back the tax over withheld. Taxpayer also has to show his/her tax number when they enjoying medical and educational benefits. The introduction of tax number system is mainly to facilitate the tax bureau to check the information obtained from the bank and other aspects and the income reported by the taxpayer, so as to prevent the taxpayer from omitting reporting an income. Taxation combines individual's independent declaration and tax bureau's spot checking; if a taxpayer declares an income far different from the actual income or indeed has omission behavior, the tax bureau will investigate and "give him/her with a heavier punishment".

C. *Personal Income Tax System in the UK*

In the UK, personal income tax is collected by means of either withholding or independent declaration. The taxpayer adopting independent declaration method has to prepay the tax once in half a year at an amount of 50% of the tax payable of the previous year. Those who fail to pay the tax as scheduled will be imposed a fine of 100 pound. Meanwhile, British government implements corresponding tax rebate policy, namely when a taxpayer's tax payable is less than the tax exemption, the taxpayer can enjoy tax rebate. The punitive and incentive modes paralleled taxation system effectively plays the active role of taxation in regulating income distribution and realizing social justice.

V. SUGGESTIONS FOR OPTIMIZING PERSONAL INCOME TAX

A. *Perfecting the Expense Deduction System*

By analyzing relevant expense deduction system of foreign countries, it is known that different expense deduction criterion are provided in accordance with the age, number and situation of family members, economic income level and other factors of the taxpayer so as to individualize the tax collection and supervision system. This case can provide positive reference for perfecting the special deduction item of personal income tax in China. For instance, in terms of housing expense, different deduction criteria can be specified on the basis of the housing price level in different region; in terms of children's education expense, different deduction criteria can be specified on the basis of children's different education stages; in terms of support for the elderly, the expense deduction criteria can be specified on the basis of the elderly's income level, the number of the elderly people to be supported and other conditions of the elderly.

B. *Appropriately Lowering the Top Marginal Income Tax*

After this reform, the implementation of unified taxation on comprehensive income lead to a somewhat increase in the top marginal income tax applicable to taxpayers of some incomes. This case intangibly causes an increase in the tax burden of some taxpayers, causing dissatisfaction; some taxpayers may seek for "reasonable tax avoidance" by other channel, causing some illegal behaviors or losses in the state's fiscal revenue. Therefore, in the subsequent personal income tax reform policy, it is necessary to appropriately consider lowering the top marginal income tax rate and improving the efficiency of tax collection.

C. *Transforming the Tax Collection and Supervision Mode*

With the diversification of taxpayer's income sources, the way of calculating and withholding personal income tax by employer cannot accurately confirm the comprehensive income of the taxpayer. The online tax filing system established in China implements the parallel collection modes of withholding by employer and independent declaration by individuals. This way is conducive to reducing the taxation supervision cost while improving the taxpayer's positivity to pay tax. In addition, it is also

suggested to learn from the "pay tax first and rebate them later" and "incentive and punitive mechanism" and other taxation mode of other countries to simplify the collection and supervision procedures and raise taxpayers' taxation awareness.

VI. CONCLUSION

Above all, in this reform, the practices of improving the threshold for personal income tax, adding special expense deduction criteria, adjusting the tax rate interval and structure, and implementing classified and comprehensive mode paralleled income tax system reflect the scientific, rational and fair natures of tax system and further perfect and optimize the current tax system in China. In short, the reform of personal income tax is constantly integrating the demands and interests of individuals, society and the state and other aspects. It is carefully summarizing experiences, deepening tax system reform while giving full play to the role of taxation in promoting national economic development and political stability to realize a modernized, rational and scientific tax collection and supervision system and tax administration concept and further show the fairness of taxation.

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