



# Tax Risk Analysis Based on Personal Income Tax and Value-Added Tax

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**Abstract.** Through the analysis of enterprise tax risks, it can be seen that we have achieved some results in tax risk management. However, compared with international large enterprises, there are still significant gaps in both the application of risk management concepts and the construction of risk auditing methods and information platforms. This article first introduces the relevant theories of risk management and brings in the topic of tax risk. Then, it analyzes the possible tax risks in reality from the aspects of value-added tax and individual income tax, hoping to provide some references for enterprises and bring some inspirations to them.

**Keywords:** Tax risk, personal income tax, value-added tax

## 1 Introduction

Today, with economic globalization and increasingly complex tax laws, conducting tax risk management for enterprises has become an important link in their business operations. Due to the lack of understanding of tax laws and policies, asymmetric information, and rapidly changing risks, enterprises' tax risk management is facing new opportunities and challenges. If enterprises want to cope with the changes in tax policies under the new situation, they must fully recognize various risks in various tax systems and deal with them accordingly.

## 2 The Connotation of Tax Risk and Tax Risk Management

Tax risk refers to the failure to manage tax-related matters, the omission of tax collection, the decline in taxpayer compliance, and the deterioration of tax source conditions caused by loopholes in policies and regulations, deficiencies in tax collection and management systems, mistakes made by management institutions or personnel, and various other uncertain factors. Ultimately, it leads to the possibility that the "three functions

of taxation" (i.e., organizing financial revenue, regulating the economy, and supervising reflections) are not fully exerted, and that tax revenue cannot meet the needs of the government to fulfill its functions [1].

Tax risk management refers to the application of risk management theories and methods by tax authorities. Under the comprehensive analysis of taxpayers and payers' compliance with tax laws, they rationally allocate tax collection and administration resources based on the tax risks of taxpayers of different enterprise types and credit ratings, and adopt a series of risk response measures such as risk warnings, tax assessment, tax audits, anti-tax avoidance investigations, and tax inspections. Tax administration activities aimed at achieving the goals of preventing and controlling the risk of tax loss, enhancing taxpayers' compliance, and improving the tax collection and management level of the tax department [2].

### **3 Analysis of Personal Income Tax Risks**

#### **3.1 The Tax Payment System was not Implemented Properly, Resulting in the Loss of Tax Sources**

Tax registration is the main source for tax authorities to obtain taxpayers' information. Under the traditional tax collection and management model, business registration, tax registration, etc. were indispensable. However, with the rise of some emerging industries nowadays, there are no strict regulations on information registration. For instance, the entry threshold for the online live streaming industry is low. To become a live streamer, one only needs to activate the live streaming function, which offers considerable autonomy. Under the cover of the Internet, it is difficult to be detected without tax registration, business registration, etc. [3]

For a long time, under the requirements of the new Individual Income Tax Law, China's individual income tax system has shifted from the initial classified income system to the current mixed income system, and the current mixed income system requires taxpayers to file tax returns. However, in reality, the income of high-net-worth taxpayers is very complex and diverse. Most high-net-worth taxpayers do not proactively declare income obtained from multiple places or other regions, which leads to the loss of tax revenue.

#### **3.2 Taxpayers' Conversion of Income Types**

For taxpayers, the applicable tax rate for individual income tax on income from wages and salaries is the highest 45%, while for income from dividends and bonuses, the proportional tax rate is 20%. Therefore, many presidents and executives of large companies will convert their salary and wage income into dividends and bonuses to obtain higher tax benefits and thereby reduce their tax burden.

In addition, in China, it is also possible to achieve the transfer of profits by setting up sole proprietorships. Although China's tax law stipulates that sole proprietorships and partnerships can use business income to pay individual income tax, it requires taxpayers to be able to calculate income and costs and set up their own accounts. However,

the reality is that in our country, the vast majority of individual business households and sole proprietorship enterprises do not have the ability to independently set up accounts and are unable to conduct cost accounting. At present, the collection of individual income tax for sole proprietorship enterprises and partnership enterprises in China is mainly carried out by the tax authorities through assessed collection or regular fixed-amount collection. However, in practice, many local governments have set a relatively low assessed income rate in order to attract foreign investment, resulting in a significant reduction in the burden on taxpayers and a large loss of tax revenue [4].

### **3.3 The Individual Income Tax System is not Perfect**

In 2019, due to the needs of tax collection and administration, China added special anti-tax avoidance regulations and general anti-tax avoidance regulations. However, China's anti-tax avoidance rules are still in the initial legislative stage and were transferred from the anti-tax avoidance regulations of enterprise income tax. There are still many deficiencies. Although anti-tax avoidance rules for controlled foreign enterprises and the "abandonment of status and tax clearance" system have been stipulated, However, the lack of corresponding detailed measures makes anti-tax avoidance less feasible and encourages the tendency to evade personal income tax.

At present, the Individual Income Tax Law adopts a classified comprehensive income tax system. Individual income tax is only levied on specific items, and the scope of collection is relatively narrow. Moreover, China has not established a capital gains tax, and the items of capital gains are also included in the scope of individual income tax collection. With the rapid development of China's economy, industries such as live streaming and e-commerce have also developed rapidly, giving rise to a large number of different types of live streamers, whose incomes are also considerable. The current individual income tax law in our country does not clearly stipulate the income of this group, giving them the opportunity to evade taxes.

In addition, due to the insufficient severity of the current laws and regulations in punishing tax violations, it is difficult to effectively deter and curb tax evasion and tax fraud. At the same time, there are many problems in the current tax collection and administration system in our country. For example, there is a lack of effective tax administration means, and information asymmetry leads to difficulties in tax collection and administration.

### **3.4 The Level of Tax Risk Management is Low**

At present, in terms of tax risk management, there still exist problems such as low management level and untimely tax risk early warning. On the one hand, tax risk management relies more on accurate data and information from third parties besides taxpayers. However, tax authorities and third-party platforms, as well as tax authorities themselves, have not achieved comprehensive information sharing.

On the other hand, the tax risk early warning and assessment mechanism in our country has not yet been established. Currently, when conducting risk management, the tax authorities in our country mostly adopt an indicator approach. There is no effective

method in terms of the subject, standards, procedures and results of risk assessment, and it is impossible to accurately grasp the key risks and risk levels and take corresponding countermeasures. In addition, the tax department has relatively few professionals and is short of technical talents.

## **4 Analysis of Value-added Tax Tax Risks**

### **4.1 Risks of Value-Added Tax Invoices**

#### **Risks of Issuing False Value-Added Tax Invoices.**

In some regions or departments, in pursuit of "attracting investment", the registration and management of enterprises are not strict enough. This provides an opportunity for professional false opening gangs to use the office Spaces of relevant authorities for industrial and commercial registration as the venues for registering commercial enterprises.

Meanwhile, some enterprises also falsely issue profits through "surplus invoices", among which the majority are retail enterprises of refined oil products and small-scale taxpayers. This is because in real life, most individual consumers do not ask for invoices when making purchases. Some companies will issue false invoices that have already been sold but not requested by the buyers to units or individuals in need, thereby making profits. If ordinary invoices are issued, it can only erode the tax base of the downstream enterprise income tax. However, if special invoices are issued, It will also erode the value-added tax base downstream.

#### **Risk of Obtaining Falsely Issued Value-Added Tax Invoices.**

There are two situations where false value-added tax invoices can be obtained: First, enterprises purchase materials from units or individuals that cannot provide invoices at a lower price and then obtain false value-added tax invoices from third parties to offset input tax. Second, enterprises, in pursuit of larger profit margins, issue false invoices to evade value-added tax. According to the subjective will of taxpayers, obtaining false invoices is classified into malicious acquisition and good faith acquisition. In practice, due to the tax authorities' difficulty in accurately recognizing and grasping the true identities of taxpayers, there exist significant law enforcement risks and risks of tax loss.

### **4.2 Risk of Concealed Income**

Most natural person buyers do not have the habit of asking for invoices. Enterprises whose end consumers are mainly natural persons may have a large amount of uninvoiced income. Enterprises can avoid taxes by only declaring the invoiced sales amount. Enterprises may also avoid taxes by delaying the declaration of sales revenue, for example: When real estate development enterprises adopt the advance payment method for sales, during the pre-sale stage of commercial housing, if the enterprise receives the advance payment, it should take the pre-sale income as the tax basis and

declare and pay value-added tax at a advance collection rate of 3%. The funds collected from the full payment sales method, the down payment, mortgage payment, balance payment collected through the mortgage method, and the deposit collected during the pre-sale should all be regarded as advance payments to calculate the advance payment of value-added tax. However, deposit of good faith, subscription deposit and advance payment do not fall under advance receipts and do not require advance payment of value-added tax. When enterprises avoid taxes, they often confuse advance payments with deposits, good faith deposits, intention deposits, etc., to evade withholding obligations and thus achieve deferred tax payment [5]. In addition, some real estate enterprises will also deposit the collected funds into personal bank cards, and then transfer the money to the company's account after they sign the contract. This creates the risk of delayed payment.

### 4.3 Risk of Fraudulently Obtaining Preferential Policies

Lawbreakers take advantage of tax preferential policies to make profits, causing great disruption to the tax order and posing a threat to national tax security and the business environment. With the gradual development of the tax system, when taxpayers enjoy tax reduction or exemption benefits, they only need to fill in the reduction or exemption information in the corresponding column of the declaration. The tax authorities will no longer verify the relevant supporting materials, and only need to keep the materials for future reference. If the conditions for enjoying the policy change, an application should be submitted in writing to the competent tax authority along with a written report.

The above-mentioned reforms have changed many preferential items from prior filing to taxpayers' self-identification, self-declaration and enjoyment, and retention of relevant materials. Although this has facilitated taxpayers, it has also increased tax risks. By forging exports or illegally obtaining export goods declaration forms with customs seals affixed by other fraudulent methods [6], and fabricating export business, etc., not only will the national tax revenue suffer huge losses, but also the market order will be greatly disrupted.

### 4.4 Risks in Tax System Design

Through the comprehensive deepening of the reform of value-added tax (VAT) and the reduction of taxes and fees, China currently has four VAT rate brackets, namely 13%, 9%, 6% and zero rate, and two collection rates, 3% and 5%. The multiple tax rates (collection rates) provide taxpayers with opportunities to "avoid taxes" in an unreasonable way. This will affect taxpayers' tax compliance, bring difficulties to grassroots tax authorities, and at the same time cause some disputes in the handling of some issues [7].

Because value-added tax is tax-neutral, its impact on economic activities is very small. In addition, its tax burden is also transferable. The output tax paid in the previous stage is equal to the input tax deducted in the next stage. Therefore, from the perspective of tax system design, it inherently excludes tax preferences. However, in the current value-added tax (VAT) system, there are many preferential policies, the changes in

these preferential policies are too rapid, which may cause loopholes in the VAT chain, increase the difficulty and complexity of tax collection and management for grassroots tax authorities, and damage the current VAT system in our country.

## 5 Conclusion

Personal income tax and value-added tax, as important components of China's tax system, face many risks and challenges in the actual collection and management as well as enterprise tax payment process.

To effectively prevent and control tax risks, government departments need to further improve tax laws and regulations, refine anti-avoidance provisions for individual income tax, and optimize the structure of value-added tax rates and preferential policies. Strengthen the informatization construction of tax collection and administration, promote information sharing between tax authorities and third-party platforms, and establish and improve the tax risk early warning and assessment mechanism; Strengthen the punishment for tax violations to form an effective deterrent. Meanwhile, enterprises should enhance their awareness of tax risk management, improve the professional quality of financial personnel, strictly abide by tax laws and regulations, and actively fulfill their tax obligations. Only when the government and enterprises work together can tax risks be effectively reduced, the stability of national tax revenue be guaranteed, and the healthy development of the tax collection and administration system be promoted.

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