

Research on Suggestions for China's Individual Income Tax System from the International Perspective

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Abstract: This paper analyzes the latest annual report of OECD, Tax Policy Reforms 2018, OECD and Selected Partner Economies, and draws lessons from the tax collection and administration systems and modes of Britain and the United States. It holds that the international trend of individual income tax reform in recent two years mainly includes: some countries continue to reduce the tax on labor income, reduce the tax burden of the low- and middle-income groups, and increase the tax on capital income. Thus, the tax system will be more inclusive, and tax policies can achieve social equity while promoting economic growth. Based on comparison and references, this study puts forward some suggestions to improve China's individual income tax system.

1. Introduction

The amendment of the Individual income tax Law is of positive significance.[1] On the one hand, it reduces the tax burden of the middle and low income groups by focusing on the personal burden in major livelihood issues such as education, health care, housing and so on, and deducts the tax to a certain extent, which is conducive to adjusting the inequality of income distribution and promoting social equity; on the other hand, the International Anti-tax Avoidance clause are increased, and domestic anti-tax avoidance is enhanced through exchanges of third-party data, which will eliminate tax inequity caused by loopholes in tax collection and administration. [2] This year marks the 40th anniversary of reform and opening up. In order to further improve China's individual income tax system, the design of modern tax system need to be examined from a more open perspective. [3] Therefore, it is necessary to understand the trend of international individual income tax and gain insights for China's improvement of individual income tax system and collection and administration.

2. International tendency of individual income tax

Individual income tax is the main type of labor tax, and also an important source of tax revenue source in many countries. In 2015, the average proportion of individual income tax in total tax revenue of OECD member countries was 24.4%. However, the income of individual income tax is quite different among OECD member countries, especially after the accession of some Eastern European countries, the difference is more obvious. [4] For example, in 2015, the highest individual income tax accounted for 55.2% of total tax revenue in Denmark and the lowest was 9.7% in Slovakia. In the past decade, after the financial crisis in 2008, the proportion of individual income tax in total tax revenue declined from 23.7% in 2007 to 23.2% in 2010. Since then, it has steadily increased to 24.4% in 2015, reflecting the income effect of fiscal consolidation measures in OECD countries. The tax wedge which reflects the burden of labor income tax showed a downward trend from 2000 to 2009. Affected by the financial crisis, member countries implemented fiscal consolidation measures. Therefore, from 2009 to 2013, the average tax wedge of OECD member countries increased from 35.2% to 36.2%. After 2013, the average tax burden on labor income began to decline moderately, with an average tax wedge of 35.9% in 2017. It is noteworthy that from 2016 to 2017, the average tax wedge of Hungary, Luxembourg, Finland, Iceland, Canada and France declined significantly, while that of Turkey, Czech Republic, Mexico, Greece, Latvia, Slovenia and Ireland has increased significantly.

3. Lessons from some countries (regions) about individual income tax system

3.1 Standard deduction and special deduction in the United States

The current individual income tax system in the United States is a combination of standard deduction and special deduction. According to the U.S. tax law, standard deduction is the amount that can be deducted from income before calculating income tax. It varies with the change of taxpayer's income, age and mode of declaration. Special deduction is the deduction of special items except standard deduction, such as mortgage loan interest loss, gambling loss, disaster loss and charitable donations. [5] Items of special deduction are numerous and complex, which increases the tax compliance costs of individual income tax. Therefore, special deductions are further simplified in Trump's tax reform plan, while deductions of interest losses and charitable donations are retained. At the same time, the amount of standard deduction is doubled. The joint declaration of husband and wife is increased to \$24,000, and the deduction standard of single taxpayers rises to \$12,000. In this reform, the deduction standard of individual income tax in the United States will gradually be based on the standard deduction, supplemented by the necessary special deduction. The combination of the two deduction systems will not only improve the tax compliance of individual income tax and taxation efficiency, but also promote social justice so that the enthusiasm of taxpayers will be aroused and tax revenue will be protected.

3.2 Informationalized tax collection and administration in Britain.

Britain has made full use of modern information technology in the collection and administration of individual income tax. The computer system of tax authorities can collect and input the relevant information of taxpayers' income and expenditure, and then audit it by itself, and further calculate the amount of tax arrears and the fines, late fees and interest caused by arrears. Finally, the system sends the statistics of taxpayers' tax arrears to the tax authorities in various regions through the internal network, and then the staff calculates the amount of tax withheld in this period and implements the tax collection procedure. On the one hand, this highly modern and systematic way of collection and administration unifies the same standard of tax policy in different areas, improves the efficiency of tax collection. On the other hand, by comparing and auditing the information sources of all parties, the loopholes of tax collection and administration can be overcome and the loss of individual income tax can be reduced.

4. Suggestions on improving China's individual income tax system

4.1 Establish a comprehensive individual tax system.

The rapid development of economy has made the income sources of Chinese residents more and more complex. The simple tax classification system cannot completely cover the income of taxpayers, but it is easy to cause unfair tax burden among taxpayers. The draft amendment to the Individual Income Tax Law proposes that wages, salaries, remuneration, and royalties should be taxed in a comprehensive way, while dividends, income from property transfer and income from property lease should still be taxed in a classified way, thus a comprehensive and classified taxation system can be gradually established. However, in the long run, this system should only be considered as a transition, and the comprehensive individual tax system is more conducive to balancing the overall tax burden of various types of income and reveal fairness as well.

4.2 Harmonious relationship between standard deduction and special deduction

The deduction mechanism of expenses is related to the actual tax burden of taxpayers and the cost of tax compliance. The draft amendment to the Individual Income Tax Law proposed that on the one hand, the amount of standard deduction should be increased; on the other hand, special deductions such as education, medical treatment of serious illness, interest on housing loans and housing rent should be lifted. Compared with the United States and other countries, China's individual income tax allows both standard deduction and special deduction, while the United States only allows one of them, so China's individual tax deduction policy is looser. However, a trend must

be seen, that is, some countries increase standard deduction while restrict special deduction in order to achieve universal benefits, reduce the cost of tax compliance, and better achieve tax fairness. Therefore, in the future design of China's individual income tax system, the relationship between standard deduction and special deduction should be coordinated, giving priority to standard deduction to reduce the resistance of individual income tax collection.

4.3 Scientific design of tax rate

Human capital is the carrier of technological development. Nowadays, when the economic growth mode is continuously changing, the incentive to human capital is particularly important. However, the current tax rate system of individual income tax in China fails to benefit the middle class with more concentrated human capital. Salary income is the main source of income from individual income tax in China. Therefore, a scientific design of tax rate is of great importance to promote the reform of individual tax and the construction of local tax system. The draft amendment to the Individual Income Tax Law put forward that the level grade of three low tax rate (3%, 10% and 20%) should be expanded. Firstly, the level grade of 3% tax rate should be doubled (monthly taxable income rises from 1,500 yuan to 3,000 yuan) and the current tax rate of 10% should be reduced to 3%. Secondly, the level grade of 10% tax rate should be substantially expanded; the current tax rate of 20% (the portion of monthly taxable income exceeding 4,500 to 9,000 yuan) and 25% should be decreased to 10%. Thirdly, the level grade of tax rate of 25% should be reduced to 20%. The level grade of the 25% tax rate (the portion of monthly taxable income exceeding 9,000 to 35,000 yuan) should be reduced, while that of the three higher tax rates 30%, 35% and 35% remain unchanged. The total number of level grades in the draft will not change, but the tax rates of specific level grades will be reduced. However, one must see that for people with multiple sources of labor income, such as technicians, the cumulative tax rate may increase their tax burden. Therefore, the tax rate calls for further simplification, supplemented by special deductions and other ways to reduce the tax burden on human capital.

4.4 Optimize the tax declaration system to realize the informationization of individual tax collection and administration.

Individual income tax is a tax levied on individuals. Its sources of tax are scattered, so it is not convenient to track and control. The improvement of tax compliance of natural persons and the decrease of the cost of individual taxation are the key to the reform of tax collection and administration, which requires tax authorities to have a strong ability to collect and process information and to fully grasp the tax-related information of natural persons. The draft amendment to the Individual Income Tax Law puts forward four major features in the management and administration of individual tax collection. First, strengthen data exchanges by introducing third-party systems such as banks, financial institutions, labor bureaus, housing administration bureaus, public security, and customs to promote the collection and administration of individual tax; second, establish personal tax registration number based on identity card number; third, clarify the legal force of tax collection and administration law on individual income tax collection and administration; four, pay taxes by means of advance payment and final settlement.

In the future, the tax declaration system can be further optimized to realize the informationization of individual tax collection and administration as follows. Firstly, an informationized tax collection and administration platform should be built to improve the taxpayer's self-declaration system, and the taxpayer's credit registration should be established to encourage those who declare tax in good faith. Secondly, we should make full use of the Internet which connects tax departments and taxpayers at all levels to update the information in real time, and apply the idea of "Internet plus tax" to the collection and administration of individual income tax and the development of local tax departments. Thirdly, the coverage of individual income tax declaration should be expanded at proper time. For one thing, taxpayers' awareness of paying taxes according to law will be improved; for another, it will pave the way for China to realize comprehensive taxation. Of course, when design self-declaration, considering that the overall tax level of Chinese taxpayers still needs to be improved, pre-declaration system adopted by some

developed countries can be learnt. In pre-declaration system, tax authorities can provide pre-declaration information for taxpayers according to their information which can be compared with the actual taxation, if there is no difference, the taxation can be directly confirmed without declaration, which greatly reduce the cost of taxpayers' compliance.

5. Conclusion

To sum up, it is inevitable to reform China's individual income tax system due to the economic and social development. It will not only contribute to the construction of China's local tax system, but also an important part of China's establishment of a modern tax system. On August 31, 2018, the Standing Committee of the National People's Congress considered and adopted the newly revised Individual Income Tax Law (hereinafter referred to as the "New Tax Law") which will be fully implemented on January 1. This is the biggest structural reform since the implementation of the Individual Income Tax Law in China, which marks a historic step in the reform of China's Individual Income Tax. The new tax law has perfected the collection system from multiple aspects, including taxpayer status, tax collection mode, deduction standard and methods, tax rate level grade, avoidance of international double taxation and anti-tax avoidance rules. Conforming to the international tendency, it embodies the basic principle of fair taxation, responds to the concerns and doubts about taxation in China, and enhances the inclusiveness and international competitiveness of China's individual income tax.

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