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Dongsheng Jin

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ABOUT THE JOURNAL

The importance of China on the global economic stage cannot be ignored, and its unique legal and tax systems are of great interest to international scholars and business people alike. China's tax system is acquiring western features while remaining entrenched in its rich cultural and historical roots. This makes for interesting study, analysis and comparison as its laws are becoming more accessible.

The Journal of Chinese Tax & Policy focuses on the policy, administrative and compliance aspects of the Chinese tax system. It also welcomes comparative studies between China and other countries. The Journal is an internationally peer-reviewed scholarly publication.

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Editorial

2019 Vol.9 Issue 1 of the *Journal of Chinese Tax and Policy* features articles on SME tax policies, deduction for individual charitable donations, and measuring social assistance based on income classes. Our consulting editor Dr Dongsheng Jin in his comment reflected on China's Tax System Reforms in the Past 40 years.

Dan Cheng and Yuxin Li's *Study into the Tax Policies Towards Small and Medium Sized Enterprises in China* has comparatively analysed the international variance in the categorisation of small and medium sized enterprises (SMEs) and have quantitatively showcased the developmental status quo of SMEs. Through observations of the contributing impacts of preferential tax policy already implemented in China, and with contrast to the implementation and effectiveness existing laws abroad, common thematic characteristics has been drawn from these experiences, allowing a recognition of areas of policy deficiencies in China for future consideration. These areas specifically include incentivising investments and innovation, reducing operational and administrative costs, and improve financing opportunities.

Zhaohui Long and Wenfei Yang's *A Study on Tax Policies for Personal Charitable Donations in China* has empirically analysed the incentive effects towards charitable donations of existing tax policies alongside its mechanisms of impact, evaluated the implications of the personal tax reform, and have also assessed various socio-economic factors underlying individuals' personal charitable donations and the degree of various impacts. This informs possible future directions of reform which could be taken to maximise incentive effects.

Shuanghua Jin's *Calculation of Effects of the Personal Income Tax – Social Assistance Policy Mode Towards Different Income Classes* has quantitatively explored the effects of this alternative practice to contemporary policies. It is shown that whilst both personal income tax and social assistance spending reduces income inequality, the overall impacts continue to be minute, as a concern requiring future structural policy reform not limited to tax system reforms.

Eva Huang
Sydney, October 2021

Study into the Tax Policies Towards Small and Medium Sized Enterprises in China

Dan Cheng and Yuxin Li^{*}

Abstract: In analyses of the role of taxation policy in the development of small and medium sized enterprises (SMEs) in China; this paper would firstly clarify the existing implementation of relevant tax policies, before exploring the empirical implications of these policies in relations to the development of SMEs. Then, through a comparative study with existing international tax policies for SMEs; and in highlighting of the differences between existing practices - a framework could be proposed in refinement of existing practices in furthering existing SME development.

Keywords: Small and Medium Sized Enterprises (SMEs), Taxation Policy, Taxation Discounts, Tax Burdens

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Small and medium-sized enterprises (SMEs) are an important force to promote national economic development and market prosperity, as well as a new force for development, a main channel for employment and an important source of innovation. Under the background that China's economic development has entered the new normal, it is necessary to continue to strengthen the tax support for small and medium-sized enterprises, to give full play to the positive role of SMEs in promoting economic development and social employment. It is of great theoretical and practical significance for the country's economic and social development to deeply study the tax policy of entrepreneurship and innovation of small and medium-sized enterprises and create a good policy environment for their healthy development

I. Definition and Categorisation of SMEs

1.1 Definition and Categorisation of SMEs in China

In 2012, in accordance with the ‘Regulations on Standards for Sizing of Small and Medium-sized Enterprises’ (Gong Xin Bu Lian Qi Ye [2011] No. 300); the State Taxation Administration (STA) have released the ‘State Taxation Administration Notification for the Sizing of Small, Medium, Large, and Micro-sized Enterprises’ (State Administration Taxation [2012] No. 615), categorising all enterprises into one of four sizes. Under the 2011 rules, the metrics of ‘extents of employment’, ‘operating sales revenue’, and ‘total corporate asset value’ would be used to holistically assess the company size.

However, in consideration of existing deficiencies regarding available information as to the ‘total value of assets’ of corporations within the tax collection system; particularly in relations to privately owned firms, the STA in its 2012 notification have rather temporarily decided on an evaluative criterion focusing only upon the metrics of ‘extents of employment’ and ‘operating sales revenue’ overall. For the financial services industry, encompassing the 5 categories of currency banking services, non-currency banking services, capital market services, financial insurance services, and other services; granted the uniqueness of the industry, alongside the recommendations by the relevant governing authorities, the STA has temporarily decided on an evaluative criterion based solely on ‘total corporate asset value’ alone.

Nonetheless, in accordance with Article 92 of the ‘Regulation on the Implementation of the Enterprise Income Tax Law of the People's Republic of China’; the categorisation of ‘small-sized enterprises’ would be as follows, in relations to the metrics of ‘extents of employment’, ‘corporate taxable income’, ‘and total corporate asset value’.

Table 1-1 Criteria for the Chinese Categorisation of Small-Sized Enterprises

Industry	Criteria
Industrial Sector Enterprises	- Corporate taxable income of less than 300,000 RMB - Employment extent of less than 100 people - Total corporate asset value of less than 30,000,000 RMB

Other Enterprises	<ul style="list-style-type: none"> - Corporate taxable income of less than 300,000 RMB - Employment extent of less than 80 people - Total corporate asset value of less than 10,000,000 RMB
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1.2 International Definitions and Categorisations of SMEs

Table 1-2 notes the categorisation of SMEs across international jurisdictions. Such, from the table, it could be observed of the similarities between the standards used abroad as contrasted with those of China, through the predominant combined use of variables such as ‘extents of employment’ and ‘total corporate asset value’, or those of ‘extents of investment’ and ‘corporate taxable income’. Through the similarities, it could be seen of the integration of Chinese standards of categorisation towards international norms.

Table 1-2 Criteria for the International Categorisation of SMEs¹

Jurisdictions	Criteria
United States	<p>Usually, small-sized enterprises are categorised as having:</p> <ul style="list-style-type: none"> - Employment extent of less than 500 people, or - Total corporate asset value of less than 5,000,000 USD <p>For special industries, including petroleum refinement, shipping, and aviation industries; small-sized enterprises are categorised as having:</p> <ul style="list-style-type: none"> - Employment extent of less than 1500 people, or - Total corporate asset value of less than 27,500,000 USD
United Kingdom	<p>Small-sized enterprises are categorised as having:</p> <ul style="list-style-type: none"> - Employment extent of 1-49 people <p>Medium-sized enterprises are categorised as having:</p> <ul style="list-style-type: none"> - Employment extent of 50-249 people

¹ Source: Xu H, ‘The Development of Small and Medium-Sized Enterprises: A Comparative Study of Small and Medium-Sized Enterprises’, (2011) 37 *Economic Research Review* 63-66; Wang G, ‘Development of Small and Medium-Sized Enterprises with Strong Core Competitiveness as an Important National Strategy – the International Comparison of Small and Medium-Sized Enterprises Development Policies’, (2011) 37 *Economic Research Review* 60-63. Xu Z, ‘Clustering Development of Small and Medium-Sized Enterprises to Strengthen National Strength: The Experience of Italy in International Comparison of the Development Policies of Small and Medium-Sized Enterprises’, (2011) 37 *Economic Research Review* 66-68; Qi L, ‘An Empirical Study of Small and Medium-Sized Enterprises in China’, (2011) 37 *Economic Research Review* 69-72; Xu C, ‘Innovation: A Comparative Study of Small and Medium-Sized Enterprises’ Development Policies’, (2011) 37 *Economic Research Review* 72-75; Liu J, ‘Development of High-Tech Industries in the Support of Small and Medium-Sized Enterprises: The Experience of Israel in the International Comparison of Small and Medium-Sized Enterprise Development Policies’, (2011) 37 *Economic Research Review* 75-78; Zhuang J, *Research on Fiscal Policy to Support the Development of Small and Medium-Sized Enterprises in China* (China: Institute of Fiscal Science, Ministry of Finance, 2011); Wang P, ‘A Complete Service System Supporting Small Business Financing and Technological Innovation: The American Experience of International Comparison of Small Business Development Policies’, (2011) 37 *Economic Research Review* 54-57; Tang J, ‘International Reference of Tax Policies to Promote the Development of Small and Micro Enterprises’, (2012) 10 *Foreign Taxation* 41-44.

Germany	Medium-sized enterprises are categorised as having: <ul style="list-style-type: none">- Employment extent of 500 people or less- Annual revenue of less than 50,000,000 EUR Small-sized enterprises are categorised as having: <ul style="list-style-type: none">- Employment extent of 10 people or less- Annual revenue of less than 1,000,000 EUR
Japan	The definitions of SMEs; for the manufacturing industry (construction and transportation industries inclusive), are firms with: <ul style="list-style-type: none">- Total corporate capital of less than 300,000,000 JPY- Employment extent of less than 300 people (including sole traders) For the wholesale industry, are firms with: <ul style="list-style-type: none">- Total corporate capital of less than 100,000,000 JPY- Employment extent of less than 100 people For the services industry, are firms with: <ul style="list-style-type: none">- Total corporate capital of less than 50,000,000 JPY- Employment extent of less than 100 people For the retail industry, are firms with: <ul style="list-style-type: none">- Total corporate capital of less than 50,000,000 JPY- Employment extent of less than 50 people Further regulations, such as the Japan Finance Corporation Act and other laws, have also established standards in relations to the definition of SMEs within special, specific industries. For the sector encompassing the manufacturing of rubber-related products, these are firms with: <ul style="list-style-type: none">- Total corporate capital; of less than 300,000,000 JPY- Employment extent of less than 900 people For the hospitality industry, these are firms with: <ul style="list-style-type: none">- Total corporate capital of 50,000,000 JPY- Employment extent of less than 200 people For the software development and information processing industries, these are firms with: <ul style="list-style-type: none">- Total corporate capital of less than 300,000,000 JPY- Employment extent of less than 300 people

<p>Korea</p>	<p>The definitions of SMEs; for the manufacturing industry, are firms with:</p> <ul style="list-style-type: none"> - Total asset value of less than 8,000,000 USD - Employment extent of less than 300 people <p>For the mining, construction, transportation industries, these are firms with:</p> <ul style="list-style-type: none"> - Total asset value of less than 3,000,000 USD - Employment extent of less than 300 people <p>For the fisheries industry, these are firms with:</p> <ul style="list-style-type: none"> - Total annual revenue of less than 20,000,000 USD - Employment extent of less than 200 people <p>For the wholesale industry, these are firms with:</p> <ul style="list-style-type: none"> - Total annual revenue of less than 10,000,000 USD - Employment extent of less than 100 people <p>For other industries, these are firms with:</p> <ul style="list-style-type: none"> - Total annual revenue of less than 5,000,000 USD - Employment extent of less than 50 people
<p>Israel</p>	<p>The definition of medium-sized enterprises are firms with:</p> <ul style="list-style-type: none"> - Employment extent of 50-100 people <p>The definition of small-sized enterprises are firms with:</p> <ul style="list-style-type: none"> - Employment extent of less than 50 people - Revenue of less than 5,000,000 USD
<p>Canada</p>	<p>Within the standards as employed by Industry Canada, the definitions of differing enterprises sizes are categorised solely based on employment extents.</p> <p>Such, micro-sized firms (across all industries) are those with an employment extent of 5 people or less. Small-sized enterprises are those with an employment extent of less than 100 people or less within secondary industries; or those with 50 people or less within tertiary industries. Medium-sized enterprises, within this categorisation, would be firms with an employment extent of between 100-500 people for secondary industries, and firms with an employment extent of between 50-500 people for tertiary industries.</p>
<p>France</p>	<p>Within a categorisation as used by the National Institute of Statistics and Economic Studies; SMEs are defined as those with an employment extent between 10-500 people. Within this broad definition, the dividing line between small and medium sized enterprises have also been established at an employment extent of 50 people. Firms with less than 10 employed people, however, would rather be categorised separately as a micro-sized enterprise.</p>

In observation of these jurisdictional standards, it could be seen of their differences in relations to the exact definitions of SMEs - particularly as resulting from the variances between the nations' levels of economic development, and also of their socio-political circumstances overall. However, it could also be observable of the similarities of the variables employed within the categorisation; predominantly the factors of employment extents and revenue, instituted largely based on an industry/sector basis - as a commonly accepted, international status quo.

Regarding existing policies in China, whilst standards of categorisation still exists within law; they are nevertheless diverse, with differing standards existing in different areas and scopes. This could be seen within the Implementation Regulations of the Enterprise Income Tax Law of the PRC, where despite it already having established the categories of small- and medium-sized enterprises, with criterion for tax benefits; a further, smaller category has been specified - that of the small-profit enterprises, corresponding to firms with a taxable income of less than 300,000 RMB. This has been done in spite of the fact that these small-profit enterprises could already be encompassed through the original SME definition. Besides this, in relations to policy implementations (such as the institution of tax incentives for SMEs in relations to value-added tax (VAT) policies); the criterion used has also been different to aforementioned standards - the policies waiving VAT payments for small-sized enterprises only applying to those with a monthly revenue of less than 30,000 RMB.

This lack of uniformity in relations to the distinction and categorisation of SMEs, seen within the multitude of simultaneously implemented statutes with differing categorisations and scopes; has not only prevented a single, clear standard from being enacted, but has further hindered the full implementation of a range of policy incentives targeted towards SMEs at large.

II. The Developmental Status Quo of SMEs in China

Table 2-1 have described the status quo of the SMEs during 2004-2013 through the variables of the number of existing SMEs alongside the tax revenues as collected from these SMEs overall. With the table, it could be seen that the number of SMEs have continually increased over time; whether it be the period from 2004-2010, or from 2011-2013. The significant decrease observable in 2011, rather than it being an actual decrease, could rather be attributed to a change in the criterion of categorisation in relations to SMEs.

However, no matter the criterion, the status quo in relations to the significance of SMEs to the economy could still be observed; with it continually making up over 97% of total firms, as a phenomenon maintained since 2004. Regarding the tax revenues as collected from SMEs, there could be seen a trend of continued, noticeable increase since 2004 overall, with it comprising of roughly 50% of all tax revenues collected - notwithstanding a slight setback in 2008. Additionally, with reference to statistics released by the State Administration for Industry and Commerce of the PRC, the significance of SMEs is only further reinforced in its role to economic development and national employment; as it has not only accounted for over 60% of GDP in China but has moreover also contributed to over 80% of existing employment in cities and towns.

Table 2-1 Developmental Status Quo of SMEs in China²

Year	Number of Total Firms	Number of SMEs	Percentage of SMEs to Total Firms (%)	Total Tax Revenue ('000s RMB)	Tax Revenue from SMEs ('000s RMB)	Percentage of Tax Revenue from SMEs to Total Tax Revenue
2004	276,474	274,339	99	95,290.3	53,598.2	56
2005	271,835	269,332	99	115,182.8	63,715.6	55
2006	301,961	299,276	99	144,535.1	79,305.4	55
2007	336,768	333,858	99	184,224.2	101,269.8	55
2008	426,113	422,925	99	239,680.0	142,533.0	59
2009	434,364	431,110	99	264,862.0	148,491.0	56
2010	452,872	449,130	99	336,558.0	181,762.0	54
2011	325,609	316,498	97	394,074.0	178,729.0	45
2012	343,769	334,321	97	442,422.0	208,179.0	47
2013	352,546	343,135	97	457,485.0	223,541.0	49

Within the category of SMEs, in official definitions, there could also be observed a categorical definition of the small-profit enterprises - this also observable in official statistics; with these small-profit enterprises representing the bulk of Mainland Chinese SMEs. This could be seen within Table 2-2, with the developmental statistics of these small-profit enterprises for the years 2013-2015.

² 中国中小企业发展年鉴编委会, 中国中小企业年鉴 2004-2013. China SME Development Yearbook Editorial Committee, 'Yearbook of China small and medium enterprises 2004-2013'.

Within these years, the total amount of small-profit enterprises has increased from 856.17 million firms in 2013 to 1334.97 million firms in 2015. This represents a significant rate of increase; whether it be an increase of 27.14% from 2013-2014, or an increase of 22.62% from 2014-15. In the latter year, it has been a status quo where despite the slower rate of increase statistically; it is still particularly significant, granted the heightened baseline figure of firms in 2014, as compared to the 2013 statistics. Such, even despite the slower rate of year-on-year increase; it has continued to increase in prominence, from small-profit enterprises representing 89.96% of total firms in 2013, to comprising of 91.58% of total firms in 2014, and then consisting of 96.99% of total firms in 2015. This significance is further demonstrated with its significance to the economy visible through the variables of employment and taxes; contributing 46.37%, 47.94%, 48.83% of total employment in the years of 2013, 2014, and 2015, respectively; and contributing also 20.13% and 21.95% of total tax revenues in 2013 and 2014.

However, despite these positive changes, particularly with their increasing economic contributions in terms of both employment and taxes as a percentage of their national totals, there are still points of concern for small-profit enterprises as an aggregate; most prominently a decrease in the percentage of total operational firms to total registered small-profit enterprises. From 2013-2015, this has fallen from 94.67% to 94.3%, then to 93.75% overall. Additionally, with the variable of the extent of profitable small-profit enterprises; there could also be observed regarding a significant decrease - from 42.44% of these firms being profitable in 2013, to 38.35% in 2014, and to 32.02% in 2015. This demonstrates not only of the difficulties for these small-profit enterprises to be developed, but moreover also the possible deficiencies in the economic environment in facilitation of the small-profit firms' continued growth and development; particularly granted the seemingly paradoxical status quo of a significant increase in the extents of these small-profit enterprises despite worsening business fundamentals for these firms overall. In particular, this may even suggest the need for governmental intervention in terms of tax policies and incentives; granted the keystone role which these incentives may have in maintaining the development of small-profit enterprises, but moreover also the utility which it could provide.

Table 2-2 Developmental Status Quo of Small-Profit Enterprises in China³

	2013	2014	2015
Total Number of SMEs ('000s)	8561.7	10885.4	13349.7
Percentage of Small-Profit Enterprises to Total SMEs (%)	89.96	91.58	96.99
Percentage of Operational Small-Profit Enterprises to Total Small-Profit Enterprises (%)	94.67	94.3	93.75

³ Ibid.

Percentage of Profitable Small-Profit Enterprises (%)	42.44	38.35	32.02
Percentage of Employment Provided by Small-Profit Enterprises to Total Investment	46.37	47.94	48.83
Newly Established Small-Profit Enterprises ('000s)	1576.2	2245.6	N/A
Percentage of Tax from Small-Profit Enterprises to Total National Tax Revenue (%)	20.13	21.95	N/A

III. Practice of preferential tax policies for SMEs in China

3.1 Recent Tax Incentive Policies Implemented in China

In observation of the development of SMEs and the constraints which it has faced; it could be seen regarding limitations faced both due to its own conditions and circumstances, but also as a result of factors stemming from the macro business landscape. Such, in the formulation of tax policies surrounding SMEs, an emphasis has been placed in alleviating the two aforementioned constraints, particularly through tax policies encouraging financing activities. In the tables below, prominent historical and existing tax policies alleviating constraints on SME development, as implemented by Mainland Chinese authorities, would be outlined.

Table 3-1 Tax Policies Targeting Extrinsic Business Environment Constraints

Document	Policy Details
Guo Shui Fa [2001] No. 37	For non-profit SMEs in the credit guarantee industry that have taken part of a national trial, the business taxes for income gained from the aforementioned credit insurance businesses would be waived for three years after confirmation from local governments
Cai Shui [2009] No. 62	SMEs in the credit guarantee industry may have their credit guarantee reserves deducted prior to enterprise income tax calculations
Cai Shui [2009] No. 99	The financial enterprises' loss reserves for loans towards the agricultural industry and other SMEs may be deducted before tax calculations

Cai Shui [2014] No. 47	A written equity transfer instrument concluded for trading or inheriting shares and giving shares as gifts via the National Equity Exchange and Quotations (NEEQ) shall be subject to stamp duty on securities (stock) transactions which is payable by the transferor at 1‰ of the actual transaction amount at the time of conclusion of the said instrument.
Cai Shui [2014] No. 48	The individual income taxes as levied upon dividends from publicly traded companies on the NEEQ would be differentiated based on the length of their holding prior to the dividend; rewarding longer-term holders of shares
Cai Shui [2014] No. 78	The financing contracts as signed between financial services firms and SMEs would now be exempt from stamp duties
Cai Shui [2017] No. 22	The relevant reserves as accrued by credit guarantee institutions in relations to SMEs financing would now be deductible prior to enterprise income tax calculations
Cai Shui [2017] No. 77	Incomes for financial services firms earned through loan interest payments from firms in the agricultural industry and small and micro-sized enterprises would be exempt from value-added taxes

Table 3-1 has highlighted the various tax policy incentives that have been implemented in relations to alleviating extrinsic constraints as faced by SMEs. Out of these incentives, a clear direction could be found, in relations to the waiving of certain tax obligations and allowing certain deductions to be done prior to tax calculations for agricultural and other SME firms overall; but moreover, also in the incentivising of longer holdings in the NEEQ through tax rate reductions. These policies overall could be interpreted as having a stimulatory effect towards financing activities for SMEs; this contextualised by the concern where the difficulty of attaining financing may even significantly hinder SMEs' development.

Table 3-2 Tax Policies Related to The Development Burden of SMEs⁴

Category	Document	Policy Details
Income Taxes	Cai Shui [2009] No. 133	For small-profit enterprises with an annual taxable income of 30,000 RMB or less, their taxable income shall be calculated at 50% of their actual income, and the enterprise income tax payable shall be at a rate of 20%.
	Cai Shui [2011] No. 117	For small-profit enterprises with an annual taxable income of 60,000 RMB or less, their taxable income shall be calculated at 50% of their actual income, and the enterprise income tax payable shall be at a rate of 20%.
	Cai Shui [2014] No. 34	For small-profit enterprises with an annual taxable income of 100,000 RMB or less, their taxable income shall be calculated at 50% of their actual income, and the enterprise income tax payable shall be at a rate of 20%.
	Cai Shui [2015] No. 34	For small-profit enterprises with an annual taxable income of 200,000 RMB or less, their taxable income shall be calculated at 50% of their actual income, and the enterprise income tax payable shall be at a rate of 20%.
	Cai Shui [2015] No. 99	For small-profit enterprises with an annual taxable income of 200,000 RMB to 300,000 RMB (300,000 RMB inclusive), their taxable income shall be calculated at 50% of their actual income, and the enterprise income tax payable shall be at a rate of 20%.
	Cai Shui [2017] No. 43	The upper limit of the amount of annual taxable income of a small-profit enterprises shall be raised from 300,000 RMB to 500,000 RMB. A small-profit enterprise with annual taxable income of not more than 500,000 RMB shall have only 50% of its

⁴ Source: The state administration of taxation website (<http://www.chinatax.gov.cn>)

		income included as taxable income and pay enterprise income tax at a rate of 20%.
Value Added Taxes	Cai Shui [2013] No. 52	The enterprises or non-enterprise entities in the small-scale value-added taxpayers with monthly sales volume of no more than 20,000 RMB shall be exempted temporarily from the collection of value added tax; and the enterprises or non-enterprise entities in the business taxpayers with monthly turnover of no more than 20,000 RMB shall be exempted temporarily from the collection of value added taxes.
	Cai Shui [2014] No. 71	The small-scale value-added taxpayers with monthly sales volume between 20,000 RMB (inclusive) and 30,000 RMB shall be exempted from the value added tax; the business taxpayers with monthly business volume between 20,000 RMB and 30,000 RMB shall be exempted from business tax.
	Cai Shui [2017] No. 76	The small taxpayers of value-added tax with monthly sale revenue of not less than 20,000 RMB (inclusive) but not more than 30,000 RMB shall continue to be exempted from value-added tax.
Other Taxes	Cai Guan Shui [2011] No. 71	The national public-service demonstration platforms for SMEs that meet the conditions shall enjoy the current tax relief policies for the import of products used for technological development and such platforms' import of a reasonable quantity of products for technological development that cannot be produced in China or whose counterparts in China cannot meet the performance requirement before December 31, 2015. They shall be exempted from import tariffs, import process VAT and consumption taxes upon the approval of the State Council.
	Cai Shui [2014] No. 39	Registered individuals with unemployment of over 6 months, unemployed individuals without an employed family member, those of working age population registered with the Minimum Subsistence for City Residents Guarantee, and high school students on the year of their graduation who

		<p>has operated as a sole trader will be granted an 8000 RMB deduction for calculations regarding business tax, urban maintenance and construction tax, education surcharge, local education surcharges, and income tax.</p>
	<p>Cai Shui [2014] No. 75</p>	<p>The number of years for the depreciation may be lessened or the accelerated depreciation method may be adopted for the fixed assets purchased after January 1, 2014 by the enterprises in the six industries, namely, biological pharmaceutical manufacturing industry, special equipment manufacturing industry, railway, shipbuilding, aerospace and other transportation equipment manufacturing industry, instrument manufacturing industry, and information transmission, software and information technology services.</p> <p>For the instruments or equipment for use in both research and development as well as production and operation as purchased after January 1, 2014 by the small-profit enterprises in above six industries, if the unit value is not more than 1,000,000 RMB, such value is allowed to be included on one-time basis in the current cost expenses for deduction in calculating the taxable income and shall no longer be calculated for depreciation by year; the number of years for the depreciation may be lessened or the accelerated depreciation method may be adopted if the unit value is more than 1,000,000 RMB.</p>
	<p>Cai Shui [2017] No. 34</p>	<p>For the R&D expenses actually occurring in the research and development activities of medium and small-sized technology-oriented enterprises, if such expenses have not formed intangible assets and included in the current-period loss and profit, an additional pre-tax deduction by 75% of the actually occurred amount shall be made during the period from January 1, 2017 to December 31, 2019, if such expenses have formed intangible asset, pre-tax amortisation by 175% of the intangible asset cost shall be made during the above period.</p>

Table 3-2 has outlined the several types of tax incentive policies in relations to the easing of intrinsic burdens for the SMEs' continued development; as reflected in the three categories of income taxes, value-added taxes, and other taxes overall.

For income taxes, the incentives for SMEs have only been promulgated beginning 2009, with the regulations at the time being that small-profit enterprises with an annual taxable income of less than 30,000 RMB would be granted an incentive, such that their taxable income would only be calculated at 50% of their actual income, and the enterprise income tax payable be paid at a 20% tax rate. However, despite this only initially applying to a limited extent of firms; the eligibility criteria has gradually expanded over time - the incentives having applied to firms with an annual taxable income of under 60,000 RMB in 2011, 100,000 RMB in 2014, 200,000 RMB, and then 300,000 RMB later in 2015, before finally increasing to a threshold of 500,000 RMB in 2017. This expansion in criteria has since allowed more SMEs to take advantage of the incentives.

In terms of value-added taxes, the governmental policy changes for this have similarly also surrounded tax deductions and their eligibility criteria overall. This is exemplified by the 2013 policy where a temporary exemption from VAT had been given to small-scale VAT payers, enterprises, and non-enterprise entities with monthly sales volume of no more than 20,000 RMB. Later, in 2014, this threshold has been increased to 30,000 RMB for eligible entities - as a policy that has been maintained until the 31st of December 2020. Nevertheless, this expansion in eligibility has highlighted the increased governmental focus and priority on SMEs, alongside a greater recognition of a need for their further development at large.

In observation of other incentives implemented through tax deductions; a greater emphasis has been placed upon encouraging innovation from SMEs. These sectors as implemented within the scheme have included the manufacturing sector for biologic drugs; manufacturing sector for specialised equipment; manufacturing sector for equipment used in railway, shipping, and aviation industries; manufacturing sectors for computing, telecommunication, and other electronic devices; manufacturing sectors for precision instruments; and services sectors in relations to software and information technology. For these sectors, incentives have been put in place through allowing faster rates of depreciation to be recorded for tax purposes for assets purchased by companies within the sector overall.

3.2 Empirical Exploration of Existing Mainland Chinese Tax Policies for SMEs

3.2.1 Medium-Sized Enterprises on the National Equities Exchange and Quotations (NEEQ)

To analyse the impacts of the implemented tax policies towards medium-sized firms on the NEEQ, 650 companies have first been selected from the NEEQ based on a series of filters, with the data range used in this case being available data from 2011 to 2016; to explore the tax revenues as obtained from these firms alongside the development of the firms themselves. The data used in the aforementioned analysis has been obtained from the Wind Financial Terminal.

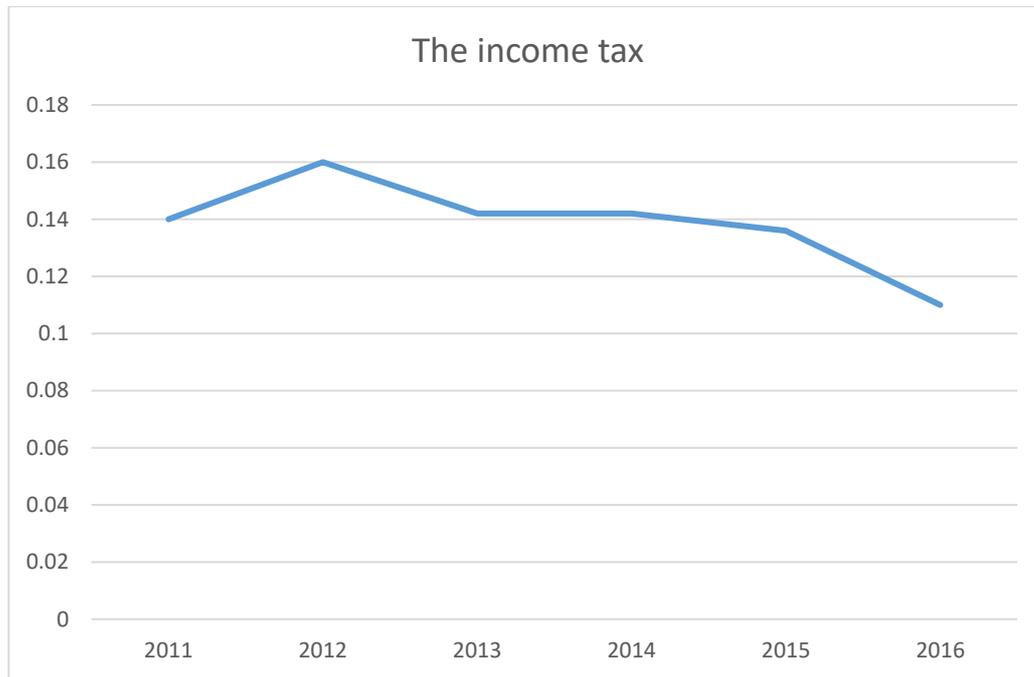
In Graph 3-1, the impact of tax policy on enterprises on the New Third Board was firstly analyzed. After data selection, 650 enterprises were selected, covering the period from 2011 to 2016. The tax revenue and development of these enterprises were analyzed, and the data were obtained from the Wind data terminal. Figure 3-1

shows the annual average income tax burden of the 650 above-mentioned enterprises. The calculation method is as follows:

$$\text{Income Tax Burden} = (\text{Income Tax Expense} + \text{Changes in Deferred Income Tax Assets and Liabilities}) / \text{Pre-Tax Profit}.$$

The above data are from the financial statements of enterprises on the New Third Board. As can be seen from the figure below, the tax burden of enterprises on the New Third Board showed a downward trend in 2011, indicating that tax policies played a certain role in reducing corporate income tax.

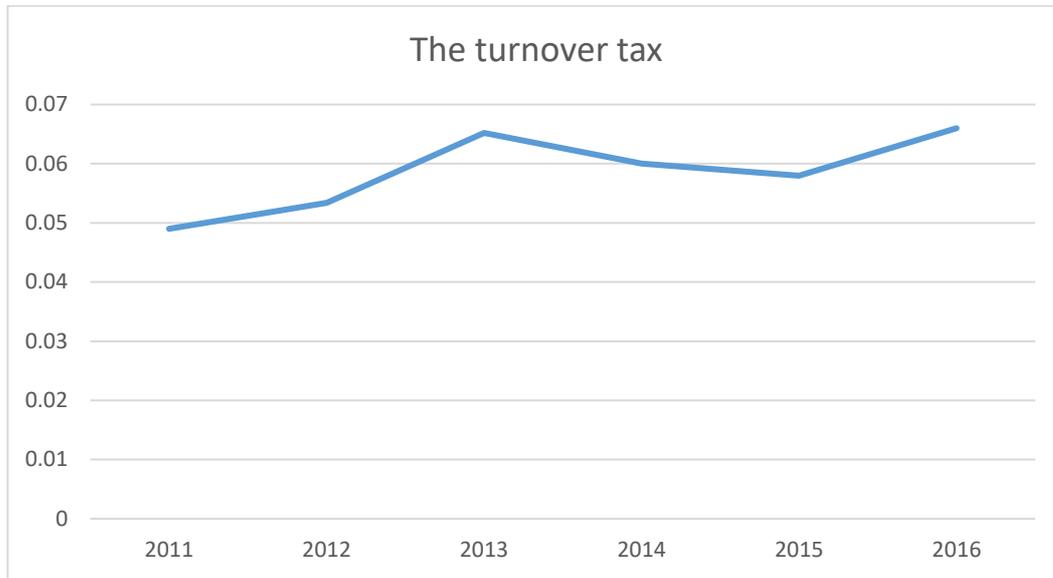
Graph 3-1 Average Tax Burdens of 650 Medium-Sized Enterprises on the NEEQ



Graph 3-2 is the tax burden diagram of turnover tax on the New Third Board. Since the main tax burden of enterprises consists of turnover tax after deduction of income tax, the turnover tax is calculated as follows:

$$\text{Turnover Tax Burden} = (\text{Various Taxes Paid} - \text{Income Tax Payable}) / \text{Business Income Excluding Tax}$$

Graph 3-2 Turnover Tax Burdens of 650 Medium-Sized Enterprises on the NEEQ



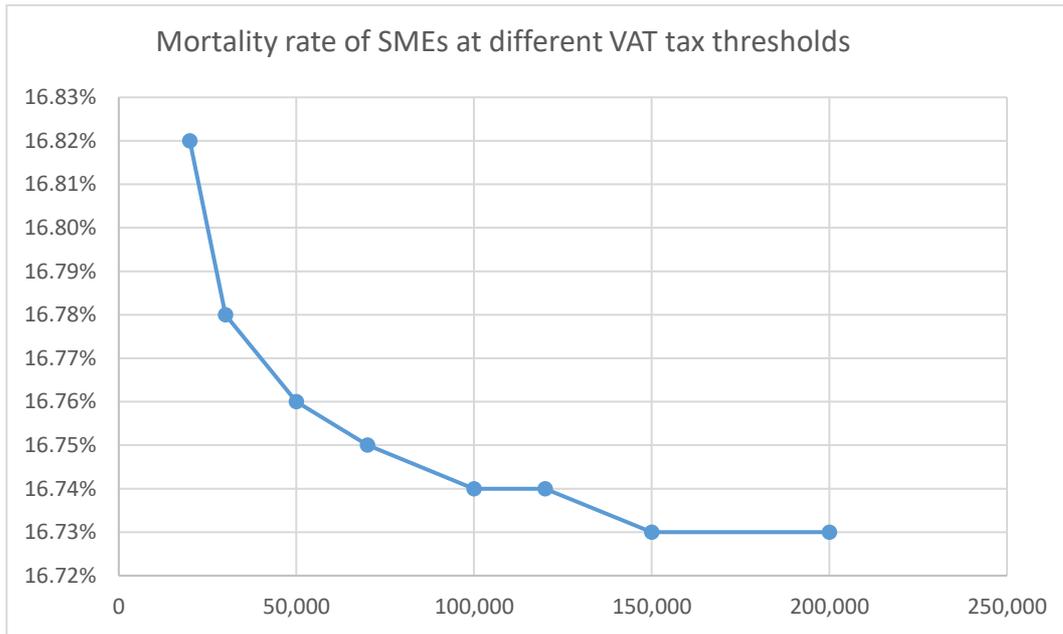
As can be seen from Graph 3-2, the turnover tax burden of enterprises on the New Third Board shows an upward trend, indicating that although China has adopted some preferential tax measures for SMEs in terms of turnover tax, these measures cannot effectively reduce the turnover tax burden of SMEs.

3.2.2 Analyses into the Tax Burdens of Small- and Micro-Sized Enterprises

With reference to the ‘Survey and Research Centre for China Household Finance’ and its ‘2014 Research Report on the Tax Policies for Small and Micro-Sized Enterprises’; the impacts of differing enterprise tax policies and incentives on small and micro-sized enterprises could be observed and explored.

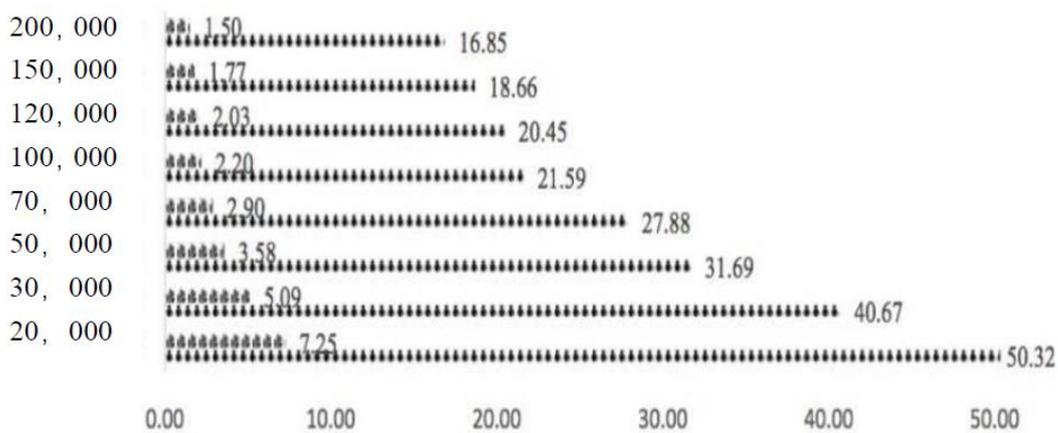
First, in relations to the variable of the tax threshold and its influence to the mortality rates of SMEs, it could be seen of a correlation; of a greater rate of survival for small- and micro-sized enterprises corresponding to a greater tax threshold overall. Empirically, this is observed such that whilst the mortality rate for SMEs has been 16.82% at a VAT tax threshold of 20,000 RMB; it has decreased to a mortality rate of only 16.73% at a heightened VAT tax threshold of 200,000 RMB. This is illustrated by Graph 3-3.

Graph 3-3 Mortality Rate of SMEs at Different VAT Tax Thresholds



Different thresholds will affect the employment of small and micro enterprises from two channels. The first channel (channel 1) is that after the threshold is raised, the operating cost of SMEs will be reduced, which will help small and micro enterprises to reduce the mortality rate and enable more small and micro enterprises to continue their production and operation, thus increasing the number of employments of small and micro enterprises, as shown in Graph. 3-4:

Graph 3-4 Impact of the change of threshold on SMEs (Channel 1)

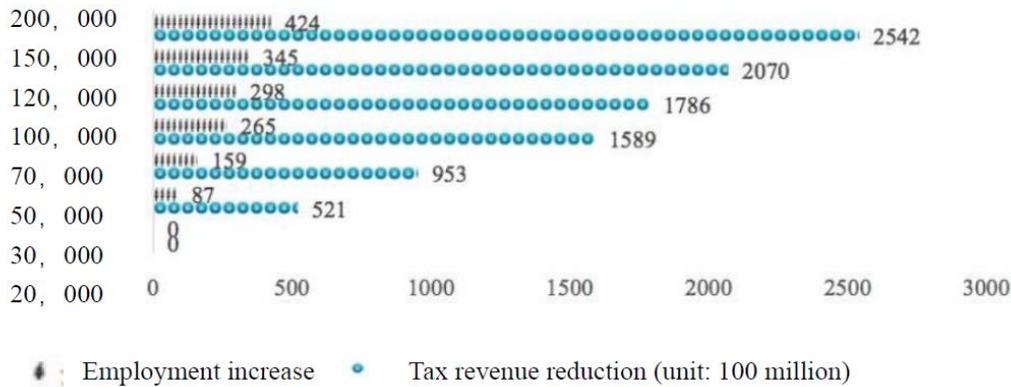


- * Number of enterprises that quit the market after taxation
- * Number of unemployed (unit: 10,000)

The latter of the transmission mechanism is such that in a case of a heightened tax threshold, the tax burdens of the small- and micro-sized enterprises would decrease as a result; this freeing up a greater extent of revenue for an expansion of operations,

in catalysing greater employment opportunities overall. This is seen in Graph 3-5 below.

Graph 3-5 Impact of the change of threshold on SMEs (Channel 2)



Third, in understanding the implications of changing tax thresholds upon the government’s tax revenues overall; previous empirical evidence could be used. Such, in the case of the tax threshold increasing from 20,000 RMB to 30,000 RMB, an increase in employment by 830,000 individuals has been observed - this coinciding with a decrease in tax revenue of 38,000,000,000 RMB. In this case, the annual cost of each additional employment position could be calculated at 49360 RMB. In addition, with the case of the tax threshold increasing from 30,000 RMB to 50,000 RMB, employment has been further increased by 960,000 individuals, though costing the government 48,500,000,000 RMB. This means that the annual cost of each additional employment position could be calculated by 50675 RMB. This is seen in Table 3-3.

In extrapolation of this trend towards an increase in tax threshold to 100,000 RMB, it could be expected for employment to increase by 2,840,000 positions; though at a cost of 14,810,000 RMB. This implies a cost per employment position of 52163 RMB - a figure still significantly lower than the cost per position of 400,000 to 700,000 RMB through the approach for added employment from investments into fixed assets alone.

Table 3-3 Influence of Tax Threshold Towards Government Tax Revenues

	20000/month-30000/month	30000/month-50000/month	30000/month-70000/month	30000/month-100000/month
Employment growth	830000	960000	1720000	2840000
Expand reproduction and create new jobs	730000	870000	1590000	2650000
Death rates are down and new jobs are created	100000	90000	130000	190000

Changes in national tax revenues	-38billion	-48.5billion	-88.8billion	-148.1billion
Changes in the threshold Tax changes	-44billion	-52.1billion	-95.3billion	-158.9billion
Contribution of tax revenue to new employment	3billion	35billion	65billion	108billion
Government spending to add one person to a job	49360	50675	51754	52163

Lastly, from a macro perspective, it could be noted of the implications of tax policy for long-term economic growth. As theorised by Lacus (1990), an excessive tax burden or a structurally distorted environment may have an impact economic growth rate overall. This has been later expanded by King and Rebelo (1990) through the construction of an intrinsic growth-based economic model, finding also of the implications of tax policies on long-term economic growth. Empirically, this conclusion of a correlation between lower tax burdens and the greater stimulatory effects on economic growth could also be verified through data from China’s development - as analyses of China’s capital and consumption tax levies have found that substantial tax burdens could hinder firm-based research and development, and serve to limit venture capital investments overall.

In the case of a reduced tax burden, however, with a reduced operating cost for the firm, and a greater ability to leverage capital for firm-based innovation; the vitality of firms could be encouraged and reinforced, in stimulation of economic growth as a result. As seen in Table 3-4, this circumstance could be observed such that when the tax threshold had increased to 50,000 RMB, the contributions to GDP from these new employments had been 77,100,000,000 RMB, representing 0.12% of national GDP in 2014. In contrast, when the tax threshold has been further elevated to 70,000 RMB, the contributions to GDP from these new employments had rather been much larger, at 138,200,000,000 RMB; now representing 0.22% of national GDP. This, in extrapolation towards a circumstance with a tax threshold of 200,000 RMB; could lead to further increases in contributions, at a potential 360,300,000,000 RMB, and consisting of 0.57% of national GDP based on 2014 figures.

Table 3-4 Influence of Tax Threshold Towards Economic Growth

threshold	Changes in business tax and value-added tax (100 million)	Increase employment (expand reproduction)	More jobs (lower death rates)	Increase in the number of total employed population (ten thousand)	Contribution of newly employed population to GDP (hundreds of millions)	percentage of 2014 GDP
30,000	0	0	0	0	0	0.00%
50,000	-521	87	9	96	771	0.12%
70,000	-953	159	13	172	1382	0.22%

10,000	-1589	265	19	284	2287	0.36%
12,000	-1789	298	20	318	259	0.40%
15,000	-2070	345	22	367	2955	0.46%
20,000	-2542	424	24	447	3603	0.57%

From the above analysis of the government's VAT (business tax) preferential policies with different thresholds on the survival rate of small and micro enterprises, on the government's tax revenue, on job creation and on economic growth, although the government will increase the threshold while bringing about a reduction in tax revenue, it will also increase employment. Moreover, if the reduction of government tax revenue is taken as the cost of increasing employment, the cost is much smaller than that of stimulating employment with fixed asset investment. At the same time, the increase of employment population caused by the increase of government threshold will promote economic growth.

IV. Experiences from the International Implementations of Tax Incentives for SMEs

4.1 Sources of Effectiveness of International Tax Incentives for SMEs

Most prominently, a source of effectiveness of these tax incentives for SMEs could be found in the primacy of the legislature with their codification of these policies into law before implementation. This is as it is only through the schematic design's codification into law that a greater mandate through increased extents of approval could be gained; in catalysing their greater implementation and enactment.

Table 4-1 Existing Laws Relevant to Tax Incentives for SMEs⁵

Jurisdictions	Relevant Laws
United States	The United States is a federal jurisdiction, where the federal government and state governments share legislative power with regard to tax laws. In order to support SMEs, local governments have issued a series of beneficial tax policies.
Japan	In encouraging the development of SMEs, the Japanese Government has codified the 'Small and Medium Enterprise Basic Law' in 1963; with many incentives for SMEs written as part of the legislation.

⁵ Ren Q & Yang J, 'International Experience and Tax Measures to Support the Development of Small and Micro Enterprises under the "New Normal"', (2015) 5 *Tax Research* 13-18.

United Kingdom	In relations to SMEs, the United Kingdom has already passed 11 relevant pieces of legislation, encompassing several key areas. This includes anti-monopoly laws to prevent large corporations from acquiring all of their SME competitors in creating a monopolistic status quo; patent laws to protect the intellectual properties of SMEs; incentives for the transferral of technological innovations and knowledge from government laboratories and universities to relevant SMEs; and laws in regulation of overdue debt obligations and breaches of contract to ensure the maintenance of adequate cash flows for SMEs.
South Korea	In order to promote the development of national economy and protect and support small and medium-sized enterprises, South Korea has stipulated the rental and tax support system for small and medium-sized enterprises in the ‘Law of Rates and Tax Reduction Rules’, ‘Tariff Law’; ‘Local Tax Law’ and other laws and regulations.
France	In further supporting of SMEs, two pieces of legislation have been codified; namely the ‘Innovation Act’ (1999), and the ‘Economic Modernisation Act’ (2008).
Canada	‘Canada Small Business Financing Act’, ‘Business Development Bank of Canada Act’, ‘Export Development Act’

Second, within international implementations of incentives for SMEs, what could also be observed is a distinct underlying purpose behind the codified pieces of legislation, in addition to a diversified use together of differing policies and laws unobservable in the Chinese business environment yet. In promoting greater entrepreneurship, governments have provided incentives such as tax-exempt period for start-up founders; in conjunction with a period of reduced taxation for the start-ups themselves; sometimes even accompanied by a reduction in the enterprise tax rate for certain eligible SMEs. Besides this, other implemented policies have included to reduce capital gains tax for eligible individuals as gained from these start-ups, or to exempt investment taxes for long term investments made by SMEs. Additionally, policies subjected to means testing have also been implemented and observed; these involving incentives such as a 5% exemption to capital gains within a 5-year period for eligible firms, and also of decreased enterprise tax rates for a certain period of time should greater equity inputs into the companies be found.

Table 4-2 Existing Incentive Policies Encouraging Entrepreneurship and Investments⁶

Jurisdictions	Relevant Incentive Policies
United States	Provided long-term investment tax deductions to small-sized enterprises with annual turnover of less than 500,000,000 USD; and has granted perpetual investment tax deductions to companies with a capital of less than 500,000,000 USD. Additionally, capital gains from small-sized enterprises are also eligible for a 5% tax deduction for at least 5 years. Moreover, losses from being a shareholder of small-sized enterprises are also eligible as tax deductions for overall income tax calculations (even with income from other sources).
United Kingdom	In encouraging investors to create start-ups; tax incentives have been designed such that individual investors investing 100,000 GBP or less per year are eligible for income tax deductions of 20%.
South Korea	For newly established SMEs; the first three years of their operations would be completely tax-free, with the subsequent two years being then eligible for a reduced rate of taxation. Additionally, the eligibility criteria for certain industries have also been expanded, and the entrepreneurial requirements reduced. Further, the government has also retrospectively expanded incentives through tax deductions in aiding of SMEs overall.
France	For newly established SMEs, the taxable income for tax calculation purposes would be halved for the first year of its establishment in addition to the subsequent 4 years. For SMEs which had received additional investments, the enterprise income tax rate would be levied at a reduced rate of 19%.
Canada	For domestically controlled firms with fewer than 15,000,000 CAD worth of assets; the first 200,000 CAD of its corporate income would be taxed at a federal rate of 12% instead of 28%, and at a state tax rate of 5-10%. For recently sold domestically controlled firms which are sole proprietorships or are in the agricultural industry, the first 500,000 CAD of its corporate income would be deductible from capital gains tax at a rate of 75%. Additionally, from 27th of February 2000, in encouraging the development of small-sized enterprises; capital gains originating from any small-sized enterprises would be exempt from taxation should it be subsequently used for investment in other small-sized enterprises too. Further, any individual shareholder to a venture capital firm who has held onto their

⁶ Cai Y & Ma Y, 'Discussion on International Experience of Tax Policy to Promote the Development of Small and Micro Enterprises', (2014) 10 *Friends of Accounting* 85-87.

	shares for at least 8 years would also have its tax obligations reduced by 15% for their first 5000 CAD of investments every year.
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Third, in terms of the policy goal specifically of encouraging innovation, successful tax incentives could also be seen abroad. This includes the United States’ granting of a reduced tax rate of 14% for capital gains of designed innovative companies, with capital gains being halved for tax calculations; Japan’s facilitation of tax deductions at 20% of the total value of research and development costs of SMEs should they be used in areas of purchasing or leasing specialised machinery, investments into new technology, or costs towards laboratory experiments; and France’s periodic exemption also of certain designed innovative companies of their income tax obligations and other taxes levied surrounding the company’s research and development. All of these policies, primarily surrounding the areas of allowing greater depreciation to be calculated for tax purposes, reducing tax obligations from research and development spending, and reducing capital gains of SMEs; could all be seen facilitating greater extents of innovation at large.

Table 4-3 Existing Incentive Policies Encouraging Innovation in SMEs⁷

Jurisdictions	Relevant Incentive Policies
United States	For designated innovative small-sized firms; capital gains halved for tax calculation purposes, with it being levied at a reduced 14% tax rate.
Japan	For acts of purchasing or leasing specialist machinery able to improve the technological capacity of SMEs; the government could provide either a special one-off depreciation of 30% of the value of the machinery, or allow the firm to be exempt from corporate tax to the value of 7% of the machinery purchase costs. Additionally, for investments made by SMEs in new technologies, the firm could have a special deduction of corporate tax to the value of 7% of the value of the machinery purchase costs. Moreover, for SMEs employing experimental laboratories, their corporate tax would also be able to be deducted by 6% of the research and development costs of the laboratory.
Canada	The costs of research and development of SMEs are tax deductible to 20% of its value.

⁷ An T & Yang J, ‘Research on Tax Policies to Promote the Development of Small and Micro Enterprises’, (2012) 28 *Economics and Management Review* (5) 5-12.

France	For investment and development by innovative firms which are established for less than 8 years, the corporate tax obligations for the firms would be waived for the first 3 years, with their tax obligations being halved for the 2 years following the waiver. The individuals involved in the project's research and development would also be exempt from social welfare contributions. For natural persons profiting of the sale of shares from innovative firms, their profits may also be tax exempt under certain circumstances. In terms of their research and development costs; for SMEs with a research and development spending of 1,000,000 EUR or less, 30% of the value of the spending could be tax deductible. For non-cash profits as obtained from investments into patents, patent-related developments, or manufacturing methods — the tax as levied on these profits could also have its due date of payment extended by 5 years.
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Preferential tax policies to reduce operating costs: In foreign countries to reduce the cost of small and medium-sized enterprises, a more common approach is to reduce the income tax rate of small and medium-sized enterprises, or to apply preferential tax rates. There are also some other policies, such as the fixed asset equipment used by small and medium-sized enterprises, the fixed asset tax is halved within 3 years; For small and medium-sized enterprises with annual sales of less than 50 million yen, the marginal deduction system of consumption tax will be implemented at a discount. Exempt businesses from VAT on annual sales of less than £3,500; Early refund of VAT refund for small and medium-sized export enterprises.

Table 4-4 Existing Incentive Policies in Reducing SME Operational Costs⁸

Jurisdictions	Relevant Incentive Policies
United States	Capital expenditures may be itemized as expenses. If the capital expenditures of the purchase of assets of small enterprises are less than USD 200,000 per year, they may be deducted as expenses. Corporate income tax is subject to progressive tax rates of 15%, 25%, 34% and 35%. As an exception to federal taxes, certain private corporations are granted the same tax options as individual businesses.
Japan	Lower corporate tax rates apply. The preferential tax rate is applicable to small and medium-sized enterprises with the capital of less than 100 million yen. The annual taxable income of 8 million yen is taken as the dividing line. For the part below this amount, the tax rate of 28% is applied (the general corporate tax rate is 35%). For small and medium-sized enterprises whose annual sales volume is less than 50

⁸ Tang J, 'International Reference of Tax Policies to Promote the Development of Small and Micro Enterprises', (2012) 10 *Foreign Taxation* 41-44.

	million yen, the marginal deduction system of consumption tax at a discount will be implemented.
United Kingdom	A relief system for small companies with less profits, with a reduction in corporation tax, such as a corporate tax rate of 25 per cent (the basic rate is 33 per cent) on revenues of less than £300,000; VAT will be exempted for businesses with annual sales of less than £ 3,500.
South Korea	Early refund of VAT refund for small and medium-sized export enterprises
France	For small businesses with assets of up to 200,000 francs, the tax limit is capped at 25% of their accounting profits
Canada	For the loss of net assets of 75% of business investment of all enterprises, it can be deducted from taxable capital income; For the loss of net assets of small enterprises in the transfer of shares or debts, it is allowed to be deducted from other income, and can be deducted from the income of the first 3 years and the next 7 years.

Last, with the simplification of administration policies, the costs and procedures involved in the adherence to tax laws have also been greatly reduced. These simplifications could be seen in measures allowing companies to choose between enterprise income taxes or individual income taxes in prevention of the double taxing phenomenon; and also, with policies including ‘pay as you go’ taxation alongside the facilitation of longer tax collection periods.

Table 4-5 Existing Policies in Reducing Administrative Costs of Tax Collection⁹

Jurisdictions	Relevant Incentive Policies
United States	For profits realized by limited liability companies with fewer than 25 employees, a choice can be made between corporate income tax and individual income tax to avoid double taxation; Small and medium-sized enterprises are allowed to adopt a cash payment system for the year of ownership of their income to facilitate tax reporting and payment;
Japan	To encourage SMEs to further their asset investments, technological research, and bolstering of their operational basis; a scheme involving tax deductions and waivers have been developed for eligible firms.
South Korea	For firms experiencing temporary difficulties in operations, tax collections could be delayed by a maximum of 9 months. Incentives such as the waiving of the tax guarantee as paid by the firms could also be observed (with this waiver applying up to a maximum of 50,000,000 KRW, or 30,000,000 KRW for normal firms).

⁹ Ren Qiang, Yang Jinliang. International Experience and Tax Measures to Support the Development of Small and Micro Enterprises under the "New Normal" [J]. Tax Research, 2015, (05):13-18.

Canada	For firms with revenue of lower than 200,000 CAD overall, the grace period for tax collections could be extended for the long term.
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4.2 Lessons from the International Tax Incentives for SMEs

In observation of the international tax incentives for SMEs, the principle of ‘taxes being enshrined in law’ has been continually seen; such that in a status quo without laws, there would also not exist taxes at large. This is especially significant, as enshrinement of tax codes into law could not only allow for a deterrent effect for their adherence by administrative bodies, but could further act in assurance of the reception of such incentives by all eligible firms. This is a status quo still needing improvement in China, as tax laws in relations to SMEs have only been limited to the single statute of the ‘Law of the People's Republic of China on the Promotion of Small and Medium-sized Enterprises’; with all other tax policies still existing as ‘regulations. Such, there could still be seen of instances of a lack of full implementation of these regulations; in preventing all eligible firms from truly benefiting from all existing incentive policies. Hence, for the future, an emphasis should be placed on formulating relevant laws in relations to the implementation of tax policies for SMEs.

In terms of specific policies, the tax incentives implemented internationally have predominantly surrounded 5 key areas and goals; in incentivising entrepreneurial investments, encouraging innovation within SMEs, reducing SMEs’ operational costs, furthering SMEs with financing incentives, and in reducing of administrative costs surrounding tax codes at large.

- a. To incentivise entrepreneurial investments, common tax policies have surrounded the provision, to eligible firms, of an extent of tax deductions (for example a reduction of enterprise income tax by 20%), of a waiver in terms of fees for a period of time, and also of an extent of tax rate reductions overall. In relations to existing Chinese regulations, because with its fewer extent of observable incentives implemented for SMEs in this regard; an emphasis could be placed in expanding existing support, through policies such as possibly allowing a faster rate of depreciation for a certain extent of purchased assets.
- b. To encourage innovation within SMEs, prominent policies have included reducing the tax rate from capital gains of innovative firms, facilitating a certain extent of tax deductions for high-technology asset purchases, allowing a certain extent of research and development expenses to be tax deductible, and also implementing a tax-free period for innovative SME firms in their infancies. In observation of existing Chinese policies, it could be seen that whilst policies have existed and has been already implemented, such as the reduced enterprise income tax rate of 15% for technological and innovative firms and a certain extent of deductions for research and development for eligible firms; the eligibility criteria for these in China has nevertheless continued to be especially high and inaccessible to most SMEs. To further stimulate the innovation of SMEs, a consideration could be made in the future for the eligibility criteria of these incentives to be expanded, to allow amore firms to be able to take advantage of such incentive policies.

- c. To reduce the operational costs of SMEs, the tax policies implemented internationally have been consistent to that of domestic Chinese policies; involving tax exemptions, a reduced rate of taxation, and a certain extent of deductions. However, with a strict definition of what could be treated as a small- or micro- sized enterprise, particularly with the employment constraints (alongside the annual turnover limits of 300,000 RMB); the incentives may ultimately have an influence contradictory to the goals of the incentives, as SMEs, which constitute the majority of the domestic sources of employment, could still be constrained by these limits. Further, whilst the additional category of the 'small-scale' taxpayers (defined through a monthly turnover of less than 30,000 RMB) have been exempt from VAT; the influence of this additional category may only serve to complicate administrative matters, and also indirectly prevent the expansion of the eligibility criteria surrounding its exemption. Such, subsequent reforms may surround the simplification of this regime, instead integrating the 'small-scale' taxpayers' category as a part of the category of SMEs.
- d. In furthering the financing of SMEs, the policies employed have generally been the provision of tax exemptions on capital gains for shareholders having held the share for a certain period, alongside the facilitation of a certain extent of tax deductions on investments by venture capital firms towards SMEs overall. However, whilst policies have been instituted in China in relations to incentives; the scope of this remains to be expanded. Possible directions could include tax incentives for venture capital investments into SMEs, and granting them a certain extent of tax deductions on their enterprise income taxes overall for a certain predetermined amount of time.
- e. In simplification of administrative procedures and costs, policies employed internationally have included the taxing of profits made by small-sized enterprises of less than 25 people through either enterprise income tax or individual income tax, to be selected by the firm, but have moreover also encompassed uses of the cash basis of accounting, provisions of grace periods for taxation, and the waiving of the tax guarantees to be paid by the firms in times of difficulty. Within these areas, a large lack of regulations could still be seen in China; particularly epitomised by the inability for individual sole proprietorships to take advantage of small-sized enterprise tax benefits (despite being encompassed within the small- and micro-sized enterprise category), with them needing to pay individual income taxes, and with SMEs in general also not having grace periods overall. In particular, the concern for grace periods is especially important, as SMEs in China would still to a large extent have inadequacies in their financial accounting processes overall.

V. Conclusion

Within this paper, the role of taxation in the facilitation of SME development has been explored. Through a comparison also with policies already implemented internationally in terms of incentives for SME development, a conclusion could be made of the future directions. In our opinion, this most predominantly involves codifying tax incentives as laws before their implementation; clarifying also within the legislation the definitions of SMEs in terms of their employment extent and

annual enterprise taxable income. A possible choice could be made allowing for the payment of either enterprise or individual income taxes could also be implemented. Next, for the incentives; specific policy goals could also be opined as embedded in their policy designs, whether that be incentivising investments, stimulating industry development, or in increasing the extents of employment. Finally, attention could be paid onto the refining of financing options for SMEs, and also of the decreasing of administrative burdens for their adherence by SMEs.

Calculation of Effects of the Individual income Tax – Social Assistance Policy Mode Towards Different Income Classes

Shuanghua Jin[☆]

Abstract: In the western countries, the individual income tax referred to as "Robin Hood tax", is that the individual income tax "Robin Hood" like Robin Hood, and social relief is the main content of the social security, low-income is difficult class to maintain basic living standard "last line of defence", which is the important tool of government regulation and promoting fair income distribution. In this paper, a model of individual income tax and social relief policy is constructed. Firstly, the income distribution and the Gini coefficient of different income groups in cities and towns are measured. On this basis, the changes of income distribution and the Gini coefficient of different income groups after they receive social relief income from the government are calculated. So, we can get the comprehensive effect of the government's individual income tax - social relief policy mode. The analysis results show that the individual income tax - social relief policy model has played a positive role in narrowing the income gap, but the effect is relatively small. The research believes that the adjustment and improvement of individual income tax policy and the government's targeted increase of social relief expenditure are helpful to the goal of adjusting the income distribution gap.

Keywords: Individual income Tax, Social Assistance, Gini Coefficient, Lorenz Curve, Policy Mode

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I. Introduction

Over the past 30 years, driven by the ‘reform and opening up’ and market forces of the socialist market economy, China has achieved rapid economic development. However, with the furthering of the existing socialist market economic structure, issues have gradually emerged; the most prominent of which has been an increasing income inequality and an elevated extent of relative poverty. Particularly, since the 1990s, there has also been an emergence of structural unemployment in the labour market, mirroring the rising urban unemployment rates and its manifestation as relative poverty. Such, under this context, a greater focus has necessitated in relations to the effectiveness of the governmental policy mode of individual income tax and of social assistance towards the goals of reducing income inequalities. This is because the governmental fiscal policies do have an observable impact in reduction of these inequalities; through the ability for individual income taxes to be levied against the higher-income earners in generation of governmental revenue, but moreover also through the ability of this revenue to be redistributed towards lower-income earners – as an institution with a duality of adjustment effects.

In terms of the impacts of this individual income tax – social assistance policy mode, it would depend not only on the extent of progressiveness of the individual income tax system, but also of the extent of assistance which is provided to lower income earners. In this process, the levying of individual income taxes as a net cost is rather both mandatory and without compensation, whereas for the provision of social assistance, a significant amount of literature has rather noted its lack of a cost or trade-off to the individual in the attainment of the social assistance benefits. In comparing income tax and fiscal expenditure policies for the goals of equity, many economists have argued that the impacts of the tax system is still very limited – because whilst more governmental revenue could be generated from the wealthy through an increasingly progressive income tax system in enabling some lower-income individuals to have their tax obligations waived altogether; the income of these lower-income individuals is still significantly limited, with an inability for taxes to raise the income levels of these groups. Noted by Bird & De Wulf¹, there is an inability for tax system to enrich the poor, such that in order to alter the income levels of those below a certain acceptable minimum, fiscal expenditure must be used – whether it be through the provision of housing, healthcare, or education; through a simple redistribution of income; or through policies incentivising greater employment. From this perspective, an analysis of individual income tax and social assistance should be done together – in generation of a holistic, meaningful analysis.

Additionally, with a significant public element regarding the provision of social assistance, there is often also a need for it to be practically supported through tax revenues; of which individual income tax is one of the most progressive taxes in China within the status quo, with it also fulfilling the purposes of mitigating inequalities of the market allocation of income. Such, in this paper, a combined analysis would be done – of individual income taxes and of social assistance together. This would also fill a gap in existing literature, as whereas analyses of the impacts

¹ Bird, R. M., & De Wulf, L. H. ‘Taxation and income distribution in Latin America: a critical review of empirical studies’, (1973) 20(3) *Staff Papers*, 639-682.

of taxation towards a redistribution of income and analyses of the effects of social assistance in alleviating poverty have already been done as individual topics; a systematic, combined analysis of the two have rather been few and far between. Of the available literature, Chen et al.² has, from different perspectives, analysed the impacts of individual income tax and minimum living standard guarantees on the distribution of income, though only focusing on the aspect of the tax-free threshold using the Gini coefficient as an analytical indicator. Li & Liu³ has analysed the optimal systemic conditions for the individual income tax, transfers, and redistribution system, though equating, in their analysis, the expenditure for social security and the costs from individual income taxes – neglecting the correlation between the social security expenditures and their later reception of an equal extent of social security income and protection. Jin⁴ has rather built upon the perspective of the income classes in calculation of the overall effects of social assistance towards the different income classes – though without consideration for the income origins of this social assistance expenditure. Such, for this paper, atop the analytical foundations of existing literature, and following data processing – a categorisation would be made in dividing urban residents into eight income classes. Using this categorisation, the individual income tax – social assistance impacts on the income and expenditure of these different income classes could then be measured, in observation of the overall changes from the policy mode, but also in analysis of its impacts towards each individual income class. The comprehensive impacts of the policy mode could thus be ascertained.

II. Analytical Models and Methods

Internationally, there are many tools to measure the income distribution gap, such as the Kuznets index, Gini coefficient, Aruvaliya index, and Sen index. But in the measurement of income distribution gap, Gini coefficient is the most commonly used by various countries. Gini coefficient is an index proposed by Italian economist Gini on the basis of Lorenz curve, which is used to measure the gap of income distribution among residents. The method is relatively simple and can reflect the disparity between rich and poor objectively. In this paper, Lorenz curve and Gini coefficient derived from it are used as the analytical model.

2.1 Discrete Choice Model

As data surrounding income distribution has predominantly been derived, and portrayed through a surveyed sample of the population, it involves a significant extent of discrete data. With the Lorenz curve appearing as a polyline as a result, the calculations for the Lorenz curve and Gini coefficient could be observed as follows:

²陈建东, 杨雯, 冯璞. 《低生活保障与个人所得税的收入分配效应实证研究》, Chen J, Yang W & Ying F, 'Income Distribution Effects of Minimum Living Allowance and Personal Income Tax of Economic Reform', (2011) 1 *Empirical Study*.

³李宇, 刘穷志 《收入不平等与最优个人所得税- 转移支付再分配系统》 Li Y, Liu Z, 'Income inequality and Optimal Individual Income Tax - transfers redistribution system', (2012) 3 *Finance Forum*.

⁴金双华, 《现行社会保障制度对不同阶层收入影响的实证分析》 Jin S, 'Empirical analysis of the existing social security system affect different income strata', (2012) 4 *Economic and Social Systems*.

Should the number of data points for individual income be represented as n , and as divided into $(T + 1)$ income classes; the initial expression could be written as follows:

$$[x_0, x_1], [x_1, x_2] \dots [x_T, x_{T+1}]$$

(with the premise that: $0 \leq x_0 \leq x_1 \leq \dots \leq x_T \leq x_{T+1}$)

In this expression, the variable of n_t would represent the number of data points contained within the income class t ; with $f_t = n_t/n$ being thus an expression of the frequency within the income class t . As derived from this, the average income within a certain income class (t) could be represented as μ_t , and the overall average income denoted simply as μ . Additionally, the variables of p_t and q_t could also be made, respectively, representing the number of data points (individuals) with incomes less than or equal to x_t as a proportion of the total number of data points and the cumulative income ratio. The following relationships could such be derived:

$$\mu = \mu_1 f_1 + \mu_2 f_2 + \dots + \mu_{T+1} f_{T+1} \quad (1)$$

$$p_t = f_1 + f_2 + \dots + f_t \quad (2)$$

$$q_t = (\mu_1 f_1 + \mu_2 f_2 + \dots + \mu_t f_t) / \mu \quad (3)$$

At this time, whilst the Lorenz curve would still be a polyline, with point coordinates of (p_t, q_t) ; a connection of these points would allow for the attainment of the Lorenz curve in full.

In estimation of the Gini coefficient where the Lorenz curve is still a polyline (GM), the formula below (the Morgan formula) could be employed:

$$GM = 1 - \{ f_1 (q_0 + q_1) + f_2 (q_1 + q_2) + \dots + f_{T+1} (q_T + q_{T+1}) \} \quad (4)$$

$$P_0 = 0, q_0 = 0, q_{T+1} = 1$$

In this estimation, with the Morgan formula, an approximate estimate of the Gini coefficient could be gained. However, with the Morgan formula only factoring in the inequalities between income classes, without calculation of the inequalities within each income class; the formula would only be truly accurate when the inequality within all income classes would equate to 0. Such, the resulting Gini coefficient estimate calculated using the equation could be viewed as a 'minimum' Gini coefficient.

2.2 The MT Index

In estimating the policy mode of individual income tax and social assistance, one of the basic aims is to compare the changes in income inequality before and after the enactment of the policy (the redistributed income). This could be simply and clearly

shown through the MT Index proposed by Musgrave & Thin,⁵, which this paper would use with the formula below:

$$MT = G - G' \quad (5)$$

Here, the pronumeral G represents the Gini coefficient before the implementation of the individual income tax – social assistance policy mode, whereas G' denotes the Gini coefficient after the aforementioned policy mode's implementation. With the index, a positive MT figure would indicate an improvement to the extent of income inequality from the income tax – social assistance policy mode, whilst a negative MT figure would highlight an exacerbation of inequality from the policy mode; a negative impact from redistribution.

2.3 Implementation of Continuous Modelling

With government policy which has a linear impact, the changes in the Gini coefficient could be articulated such:

Assuming the variable X is a random income variable to the Gini coefficient G , and that the Gini coefficient of the linear function $(a + bx)$ ($b > 0$) is G^* , then:

$$G^* = b\mu G / (a + b\mu) = [1 - a / (a + b\mu)] G \quad (6).$$

Where $\mu = E(x)$

Thus, it is evident that when $a = 0$, $G^* = G$. This means that when all incomes are multiplied by the same constant, the extents of income disparity would remain identical; though this also means that when $a > 0$, $G^* < G$; when $a < 0$, $G^* > G$.

Whilst the policy mode of individual income tax – social assistance would have a multitude of impacts towards the distribution of individual income, in many instances this income and expenditure is in a linear form. Some cases involving a non-linear circumstance could also be compared with linear cases. These are some typical examples:

2.3.1 Friedman's Negative Income Tax System

In terms of maintaining minimum incomes, Friedman's negative income tax model has been widely supported. His basic conceptualisation is that those below the poverty line would be able to receive cash grants, whereas those with incomes above the poverty line would rather need to be taxed. Such, this negative income tax system would link together the institutions for social assistance with frameworks for individual income tax; differing from the existing system and standards regarding the poverty line or the individual income tax deductions. Rather, the negative income tax scheme serves to combine the two criteria together.

Within Friedman's negative income tax system, the simplified model assumes that with an N amount of individuals in society, with the i th member of society having x_i

⁵ Musgrave, R.A. and Thin, T. 'Income Tax Progression' (1949) 48. *Journal of Political Economy*, 56, 98-514.

as its income, and with Q being the balancing point of income and expenditure for individuals in society (where both net social assistance and net tax are at 0) ($Q > 0$); individuals with individual income less than Q would receive governmental social assistance, whereas individuals with individual income greater than Q rather needs to pay tax. In a case where the marginal tax rate of both positive and negative income tax are set as β , where ($0 < \beta < 1$), then the net tax payable for social member i would be expressed as:

$$T_i = -\beta (Q - x_i), \text{ where } x_i < Q \quad (7)$$

$$T_i = \beta (x_i - Q), \text{ where } x_i > Q \quad (8)$$

The two expressions could then be unified into:

$$T_i = \beta (x_i - Q) \quad (9)$$

At this point, the disposable income for social member i could be expressed as:

$$d_i = (1 - \beta) x_i + \beta Q \quad (10)$$

On the above formula, the conclusions which we could use would include the Gini coefficient of the after-tax disposable income (for both positive and negative income tax payers):

$$G_d = (1 - \beta) \mu G / [\beta Q + (1 - \beta) \mu], \text{ where } \mu = E(x_i) \quad (11)$$

From this, it is attainable that $G_d < G$. This means that if the marginal tax rate of β remains unchanged, then an increase in the point of the income-expenditure balance Q would be able to catalyse a decrease in the after-tax (factoring in both positive and negative income tax) Gini coefficient in measurement of disposable income. This is because there would be an increase in assistance being provisioned to those with income less than Q , which is the point of the income-expenditure balance.

2.3.2 Subsidies to Societal Members with Income Levels Below the Minimum Income Level for Income to Reach the Minimum Income Level

Similar to the subsistence allowance policies already-implemented in many Chinese cities, this is a model for social assistance, and is also a model broadly representative of models for social security. This differs to the above model surrounding the form of the negative income tax. Such, assuming that the taxes for positive income tax scenarios remain unchanged, then the net tax payable for social member i for this model could be expressed through:

$$T_i = - (Q - x_i), \text{ where } x_i < Q \quad (12)$$

$$T_i = \beta (x_i - Q), \text{ where } x_i > Q \quad (13)$$

In this case, the disposable income for social member i would be:

$$d_i = Q, \text{ where } x_i < Q \quad (14)$$

$$d_i = (1 - \beta) x_i + \beta Q, \text{ where } x_i > Q \text{ (15)}$$

Within this model due to its non-linearity, the above conclusions could not be applied directly. However, the Lorenz curve and the formulae for Gini coefficient calculations within the discrete choice model could still be applied in comparison between this model and the negative income tax system. Applying the same marginal tax rate (β) and point of the income-expenditure balance (Q) across both models, it could be seen that the total social assistance expenditure from the second model is greater than the first system; with this increase being afforded to individuals with income lower than Q . The weighting of income received by the lower income groups would also increase relative to the income of the total population within the second model. Such, the outcomes in terms of income equality would be better within the second model as compared to the first.

2.4 Analytical Rationale

As an indicator facilitating a collective analysis of the income inequality, the Gini coefficient has the advantages of being holistic, empirical, and as a relative measure of income distribution. However, there are also several shortcomings, namely: 1) its inability to reflect changes in the distribution of income across income classes, 2) the same Gini coefficient could be produced by several intersecting Lorenz curves, 3) it is insensitive to the changes in income weighting for low-income classes. As a response, the income distribution Lorenz curve would be used to analyse the changes in income weighting between different income classes; in mitigation of the shortcomings of the Gini coefficient, but also in revealing the inadequacies of the individual income tax – social assistance policy mode.

In order to analyse the impacts to income distribution from the individual income tax – social assistance policy mode, a framework for the measurement of the policy mode's distribution of assistance must be established. The analytical rationale is as follows: first, as premised upon the model, the initial total incomes of the different income classes, the distribution of income, and the Gini coefficient needs to be calculated. Then, following the implementation of the individual income tax policy, the variables of the total incomes of the different income classes, the distribution of incomes, and the Gini coefficient must be measured again. Next, factoring in the element of social assistance – changes in the variables of total income of the different income classes, the distribution of incomes, and the Gini coefficient should again be calculated; in analysis of the overall implications and effectiveness of the individual income tax – social assistance policy mode, and as a premise to provide policy recommendations for a refinement of relevant rules and regulations.

III. Data Selection and Measurement

With a lack of systematic data on individual income tax and social assistance for rural residents, this paper would rather analyse the per capita income or urban households. The data is primarily derived from the 'China Urban Life and Price Yearbook' over the years; with the relevant content to the individual income tax – social assistance policy mode being its documentation of the individual income tax payable alongside the extent of governmental social assistance provided to differing income classes.

For the goal of adjusting income distribution, the progressiveness of the individual income tax system has catalysed its importance. Within the individual income tax – social assistance policy mode, this redistribution of income could be abstractly summarised into two stages; the first stage being the national levying of individual income taxes towards differing income classes to reduce the initial income disparity, and the second stage being the utilisation of this tax revenue through social assistance as a subsidy to the beneficiaries – as another round of the redistribution of income across the income classes. In China Urban Life and Price Yearbook, the disposable income is equivalent to total income, as subtracted by expenditure from individual social security levies, taxes payable, or an accounting stipend for households documenting expenses for the yearbook. With the accounting stipend, because of the low extent of the stipend provided and with there being a lack of universality regarding the provision of the stipend (only available to surveyed households), the data would such be excluded from analyses below.

Within the following analyses, the data would be divided into three categories – category A: the initial income of urban residents, that is, the income prior to making tax payments and receiving social security; category B: the post-tax income of urban residents (calculated based on initial income); and category C: the post-tax income of urban residents with the social assistance payments factored in. With these categorical definitions, a comparison between categories A, B, and C would allow for better analyses of the overall effects of the policy mode of individual income tax – social assistance. However, as the raw data of the yearbook has not been provided, calculations would need to be made to attain the figures for each category. The details of the calculations based on the yearbook data is as follows:

Category A: total income as subtracted by social assistance; in ascertaining the initial income prior to the reception of social assistance.

Category B: total income as subtracted by social assistance and individual income tax payable, as calculated by deducting income tax figures from data in Category A.

Category C: total income as subtracted by individual income tax; as calculated by factoring in the income from social assistance and an expenditure in the form of mandatory contributions to pension funds in ascertaining the overall effects of the individual income tax - social assistance policy mode.

3.1 Data Analysis and Calculation from the Sampled Data of 2011

For more detailed analyses of the effects of the individual income tax – social assistance policy mode, this paper would specifically focus on analyses of 2011 data. The distribution of income from the policy mode towards differing income classes is reflected below:

Table 1: Pattern of Income Distribution with Different Income Classes Under the Individual income Tax - Social Assistance Policy Mode

Category	Change in Total Income	Lowest Income Households	Minimum Income Households	Low Income Households	Lower-Middle Income Households	Middle Income households	Medium Upper Income Households	High Income Households	Highest Income Households	Gini Coefficient
A	100%	0.0143	0.0179	0.0538	0.1378	0.1746	0.2242	0.1452	0.2321	0.3239
B	99.27%	0.0144	0.0181	0.0541	0.1386	0.1754	0.2246	0.1450	0.2297	0.3212
C	99.52%	0.0152	0.0186	0.0544	0.1386	0.1752	0.2241	0.1447	0.2292	0.3189

Source: Calculated from China Urban Life and Price Yearbook (2012) Data

Within the table, the total income is simply the sum of the incomes of all the income classes; with the changes in total income being obtained by comparing the total income of categories B and C with the initial income of category A, which is defined as 100%.

Seen in the table above, following the payment of income tax (Category B as compared to Category A), the relative incomes of the six income classes from ‘lowest income households’ to ‘medium upper income households’ has all increased, whereas the two highest income classes, namely ‘high income households’ and ‘highest income households’ has rather had their relative income decreased; leading to a reduction of the Gini coefficient. Further, with the provision of social assistance to various income classes (Category C as compared to Category A), the relative incomes of the five income classes from the ‘lowest income class’ to the ‘middle income class’ has also increased, whereas the three highest income classes have rather experienced a decrease in relative income. This has further led to a decrease in the Gini coefficient, suggesting that the individual income tax – social assistance policy mode has led to an overall increase of societal equity.

In observation of the total income, it could be seen that whereas individual income tax comprises of 0.73% of Category A (100% - 99.27%), the extent redistributed through social assistance is only 0.35% of total Category A income (99.52% - 99.27%), indicating a net loss for residents of 0.48% (100% - 99.52%) in the implementation of the individual income tax – social assistance policy mode. From these analyses, it could be found that the social assistance expenditure is only 47.95% of the revenue from individual income taxes received (0.35% / 0.73%); highlighting that whereas a portion of the individual income tax revenue have indeed been used for social assistance, there is still a significant portion not spent for social assistance purposes.

Below, an analysis would be made of the changes in Gini coefficient, and the extent which individual income tax and social assistance has contributed to this change.

Table 2: Changes in the Gini Coefficient Due to the Individual income Tax – Social Assistance Policy Mode

-	Initial income	After Individual income Tax Collections	After Social Assistance	After the Individual income Tax – Social Assistance Policy Mode
Gini Coefficient	0.3239	0.3212	0.3216	0.3189
Decreases in Gini coefficient	-	0.834%	0.710%	1.544%
Contribution rate of different policies	-	54%	46%	100%

Source: Calculated from China Urban Life and Price Yearbook (2012) Data

Reflected in Table 2, the individual income tax – social assistance policy mode has decreased the 2011 Gini coefficient by 1.544%. Of this decrease, 0.834% is attributable to individual income taxes, and 0.710% is attributable to social assistance – a relatively smaller impact compared to income taxes overall. The causes of this phenomena are twofold, the first being the low extent of individual income taxes levied relative to total income, with an average of 0.71%, and a peak of only 1.73% for highest income earners. Additionally, it is also due to the even lower extent of social assistance provided relative to total income; with an average of only 0.23%, with a peak of 5.58% for the lowest income earners.

3.2 Impacts of the Individual income Tax – Social Assistance Policy Mode on the Gini Coefficient and MT Index Values in Various Years

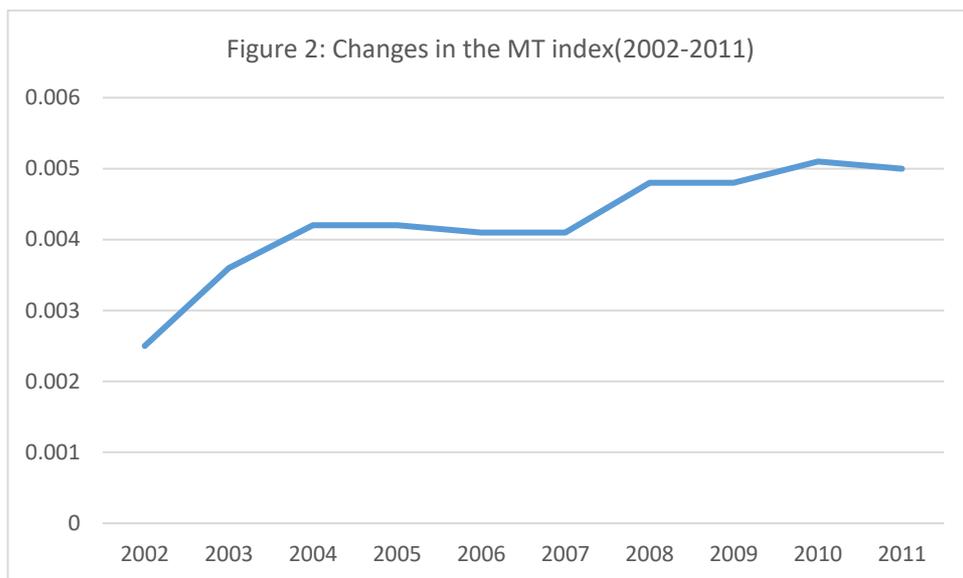
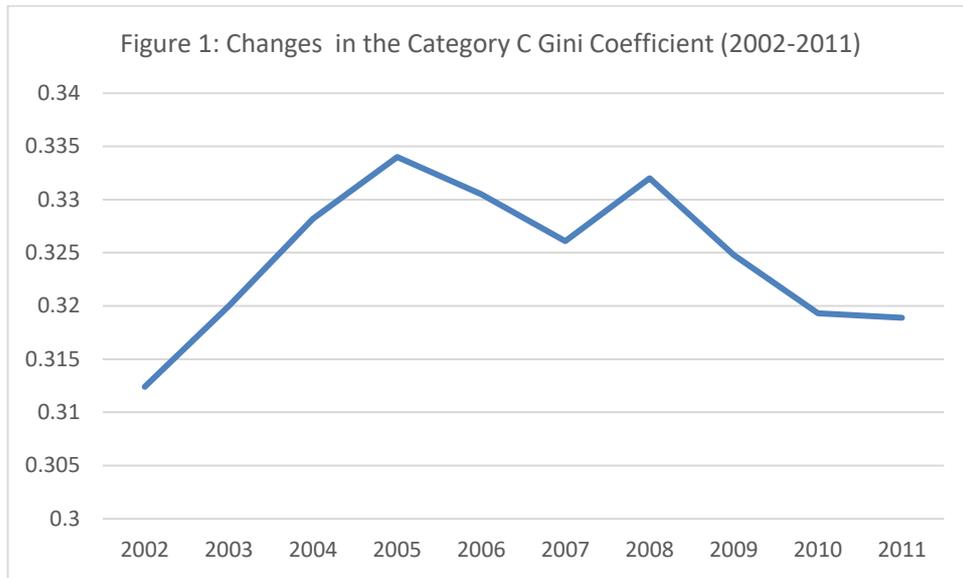
In this section, holistic analysis would be done regarding changes in the Gini coefficient and the values of the MT Index from 2002 onwards. The following table shows the data calculated for the aforementioned Categories A, B, and C alongside the MT Index values of various years.

Table 3: The Individual income Tax – Social Assistance Policy Mode Effects on the Gini Coefficient and MT Index

-	Category A	Category B	Category C	MT Index
2002	0.3149	0.3139	0.3124	0.0025
2003	0.3236	0.3219	0.3200	0.0036
2004	0.3324	0.3302	0.3282	0.0042
2005	0.3382	0.3359	0.3340	0.0042
2006	0.3346	0.3324	0.3305	0.0041
2007	0.3302	0.3277	0.3261	0.0041
2008	0.3368	0.3343	0.3320	0.0048
2009	0.3296	0.3270	0.3248	0.0048
2010	0.3244	0.3215	0.3193	0.0051
2011	0.3239	0.3212	0.3189	0.0050

Source: Calculated from China Urban Life and Price Yearbook Data from Various Years

To showcase the changes more initiatively in the Gini coefficient and the values of the MT Index, the shifts in the Category C values of both variables are graphed below:



Evident in the above charts, the Gini coefficient of urban residents (of Category C) has resembled an ‘M’ shape, fluctuating between the range of 0.31-0.334 without significant year-on-year changes. Viewed also within the charts, it could be observed that there is a trend of a declining Gini coefficient for Category C since 2008; indicating a more positive effect in the implementation of the individual income tax – social assistance policy mode towards a reduction of income inequality.

In relations to the changes of the MT Index from Categories A to C, it could be seen regarding a trend of increasing fluctuation, suggesting the occurrence of a positive redistribution effect in reduction of the residents’ income inequalities. This, on a basic level, reflects the policy features of the individual income tax – social assistance policy mode, though the effects of this policy mode remain limited as mentioned in earlier analyses.

IV. Conclusions and Recommendations

From this paper's analyses, it is shown that the individual income tax – social assistance policy mode has an effect in reducing income inequality; with individual income tax currently having a greater effect than social assistance. However, the overall impacts of this policy mode remain overly limited, with the income inequality issue remaining persistently large. This could be attributable to factors including an inadequate extent of progressiveness within the individual income tax system, a low extent of social assistance expenditure, and the lack of significant change to the income composition of lower income classes relative to total income. Additionally, within this paper, whereas calculations have indicated that the extent of revenue attained from individual income taxes are still very limited, an inadequate provision of only half of this tax revenue towards social assistance would only further policy inadequacies. Based on these concerns, the following recommendations could be made:

1. It can be further explored the feasibility of constructing the automatic and stable fiscal policy of the individual income tax on the government's social relief expenditure and figured that the individual income tax is the main source of funds for the social relief expenditure. The practice of linking specific taxes with specific expenditures is not compatible with tax work, but it should be feasible from the point of view of individual income tax, especially when the income gap is relatively large. This practice has the advantage of fund guarantee and short time to solve the problem of excessive income gap. (An exploration should be done regarding the feasibility of an automatically stabilising fiscal policy linking individual income tax revenue to the provision of social assistance; in which case individual income tax revenue would be the primary contributor to funding for social assistance. This is because whilst the practice of linking specific taxes to certain expenditures is not necessarily compatible with taxation work, it may still be feasible from the standpoint of the individual income tax; particularly in light of the large extent of income inequality, as this approach could potentially alleviate the income inequality through the provision of guarantee of concrete funding for social assistance, and is also oriented in the short term.)

2. The individual income tax system should be further improved, and the tax system should be combined with the classification. This tax system has the characteristics of both the comprehensive model and the classification model, which can not only solve the problem of unfair tax burden existing in the classification tax system, but also treat individual income items differently according to specific policy objectives. However, the implementation of the tax system mode combining comprehensive, and classification needs to have the corresponding collection and management and supporting conditions. If there is not a set of appropriate collection and management measures to cooperate and guarantee, a fairer tax system design in theory may bring greater injustice in practice. Therefore, at present, great efforts should be made to improve and perfect the supporting measures of collection and management, including strengthening cash management and vigorously promoting residents' credit card or check settlement system; The computer network between different banks will be realized as soon as possible; On the basis of the real-name registration system for personal deposits, a real-name registration system will also be implemented for personal financial assets, real estate and important consumer goods

such as automobiles. To establish and perfect the customs, industry and commerce, labour management, entry and exit management, cultural management, foreign institutions, and commercial & examination & legal departments to the relevant tax authorities to provide personnel and income situation of information system in economic intercourse and etc, with the system safeguard, synthesis and classification of combining the individual income tax reform can be smoothly.

3. Improving the subsistence allowance system and further increasing the level of social assistance. There are two aspects needed to be addressed: First, to establish a reasonable security index system. With the development of economy and the improvement of people's living standard, it is not scientific and reasonable to define the standard of subsistence allowance only from the poverty line and Engel's coefficient. The minimum guarantee can be determined from four aspects: basic food needs, non-food needs, family size and local price income level. In terms of food security, low or medium energy intake standards recommended by the Chinese Nutrition Society are the main criteria. Non-food needs such as water, electricity, shelter, children's education and medical needs are calculated separately based on the family situation; In addition, dynamic adjustment mechanisms should be established based on local price indices and income levels. The second is to accurately select the minimum guaranteed groups. At present, the minimum living guarantee system in China implements the "difference subsidy", that is, the minimum living guarantee standard is determined according to the average income level of each region, and the difference below the minimum level is subsidized, which will make some people falsify or conceal their income, making the security system ineffective. The family circumstance that needs branch of civil administration of each district, street office and community neighbourhood committee to apply for low to protect a crowd and income level strictly, therefore, ensure the operation efficiency of the lowest life guarantee system. The guarantees surrounding a minimum living standard should be further improved, and the levels of social assistance elevated.

4. Establishing a sound urban poverty alleviation and assistance system. To further solve the employment problem of low-income people, the composition of low-income people can be based on the situation, in addition to the elderly and children and other vulnerable groups who do not have the ability to work, most of them are laid-off workers, sickly people and people with low educational level. They themselves have a certain ability to work, but because of physical conditions and educational level cannot find suitable employment opportunities. Therefore, it is necessary for governments at all levels to carry out vocational education and training for local unemployed low-income people and improve their vocational skills. An education assistance system should be established for low-income groups, which can provide education assistance according to different family conditions or encourage senior talents to return home according to local development conditions, to promote local economic development and help poor families get rid of poverty. To improve the medical assistance system for low-income people. The Chinese government is considering a system of sharing medical expenses according to different family conditions and for serious illnesses, and a system of regular subsidies for the rehabilitation of health care in the later stage, so as to ensure that low-income families will fall into the vicious situation of becoming poorer because of illness.

A Study on Tax Policies for Personal Charitable Donations in China

Zhaohui Long and Wenfei Yang[☆]

Abstract: Recently, with the rapid development of charities in China, personal charitable donations mainly from the working class, which is affected by individual tax policies, have grown fast. Based on the survey data from questionnaires about China's labour force in 2011 by Centre for Social Survey (CSS), Sun Yat-Sen University, this paper studies both individuals tax policies and non-tax factors that would influence personal charitable donations. According to the research, the effective tax rate of the individual income tax has a positive correlation to the amount of personal charitable donations - on which tax deductions policy has an incentive effect. The higher the education level, the more influence the tax deductions policy would have; despite this being weakened by Engel's coefficient. This influence of tax deductions policy is also weaker, and the incentives of effective tax rate is stronger, on the low-income than the high-income groups. However, both policies would have a stronger influence on areas with a larger income inequality than areas with a smaller income gap.

Keywords: Personal Charitable Donations; Tax Deductions; Effective Tax Rate; Education Level; Engel Coefficient

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On January 1st, 2006, Wang Zhenyao, the Director of Relief Agency at the Ministry for Civil Affairs (MCA), has launched an ‘experiment’ of donating 5 hundred yuan, aiming to target the reform of charities in China. When asked by reporters in disaster mitigation center during an exclusive interview, Wang said, “Who would have thought that it has taken two months, with ten bureaucratic procedures just to cut a fifty-yuan tax?” In 2012, when Zhang Wangchen, a researcher in Research Center of Social Work and Volunteer Service at the Beijing Normal University, has done a survey on permanent residents aged over 18 in Mainland China by means of multistage sampling, it has found that when asked about whether they had ever gotten a tax discount certificate, over half of the respondents who had donated to charity in 2010 said that they haven’t requested for it. Along with respondents who have not known about this policy, 91% of all individuals have never received a certificate.¹ From May to July in 2013, when the People’s Daily Online launched a survey on the public perceptions and attitudes towards charities in China, the results have also demonstrated that 70% of the interviewees have thought that the level of development of China’s charity is inferior to that of developed countries. with more than 90% of interviewees also knowing little about the tax deduction policies for donations in China.

In recent years, charities in China have developed rapidly. The Wenchuan Earthquake in 2008 has greatly aroused the charitable consciousness of society, with 70 billion yuan raised in assistance of the disaster-affected regions, and with many enterprises also making large donations.² However, this also raises several questions; what is the status quo of personal charitable donations in China? Which income tax discounts are available for personal charitable donations? What are the incentive effects of the discounts for personal charitable donations? Does the bureaucratic procedures for the individual income tax management affect personal charitable donations? These questions will all be discussed in this paper.

I. Research Background, Objectives and Methods

1.1 Current situation of personal charitable donations in China

According to the annual report of China’s charitable donations released by China Charity Information Centre of MCA, from 2007 to 2012, statistics for the personal charitable donations is shown in Table 1. With the exception of the Wenchuan Earthquake in 2008, personal charitable donations have developed steadily from 2007 to 2010. However, following the “Guo Meimei Incident”, the extent of charitable donations have decreased in 2011.

From 2007 to 2012, with overseas donations accounting for less than 10% in the overall donations, societal donations in China have come primarily from domestic sources. In 2012, the amount of cumulative societal donations have been 817 billion, consisting respectively of domestic and overseas donations of 747.81 billion and

¹ Zhang Wangcheng, “An Empirical Study on Contemporary Donation Management and its Problem in China”, *China Soft Science*, VIII(2013), pp.163-169

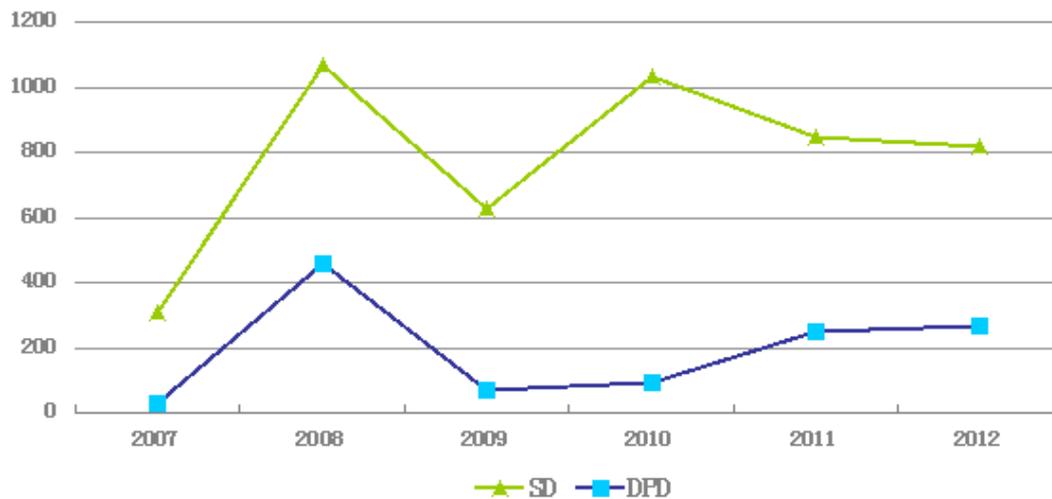
² <http://www.charity.gov.cn/fsm/sites/newmain/preview1.jsp?ColumnID=286&TID=20101223162824828646847>.

69.52 billion.³ Within domestic donations, cooperate donations were the backbone of donations, though individual donations have been increasing each year. Shown in Table 1, in 2007, individual donations made up 10.35% of overall social donations; while in 2008, the number rose to 42.80%. However, though this figure decreased to 10.84% in 2009 and 9.34% in 2010, it again rose up to 29.52% in 2011 and 32% in 2012. As shown in Figure 1, the gap between individual and gross donations has also narrowed since 2007, showing that personal charitable donations have played an increasingly important role in society.

Table 1 Amount and Proportion of Social Donations (SD) and Domestic Personal Donations (DPD) from 2007 to 2012 (Billion Yuan)

	2007	2008	2009	2010	2011	2012
SD	309	1070	630	1032	845	817
DPD	32	458	68.27	96.47	250	267.16
Proportion	10.35%	42.80%	10.84%	9.34%	29.59%	32.70%

Figure 1 Social Donations (SD) and Domestic Personal Donations (DPD) from 2007 to 2012 (Billion Yuan)



³ <http://www.charity.gov.cn/fsm/sites/newmain/preview1.jsp?ColumnID=362&TID=20130925084543284400468>

1.2 Tax Deduction Policies for Personal Charitable Donations in China

In light of the fact that individual donations, granted the flexible delivery of aid and low operation cost, would have the effect of narrowing the gap between rich and poor, and to also enhance mutual trust in society, the government has strongly supported it through implementing tax deduction policy for personal charitable donations. According to No.6 File [2007] of Ministry of Finance (MOF) & State Administration of Taxation (SAT), when taxpayers make donations through social bodies engaged in public welfare and foundations approved by the MCA, which also conforms to the regulations and is confirmed by finance and taxation department, they would be granted tax deductions in calculation of individual income taxes. No. 160 File [2008] of MOF & SAT confirms further that if taxpayers make donations through institutions which are granted tax deduction in full amount by MOF & SAT, they are also granted to do tax deduction for the donation in full when calculating the individual income tax payable. In addition, individuals who make donations through non-profit organization and government agencies in China, granted that the donation is less than 30% of income tax payable, would be able to deduct the donated amount in full – though any donations beyond the 30% standard could neither be deducted nor carried over. The policy has been implemented from 2008 since.

As for sudden disasters such as the Yushu Earthquake and Zhouqu Mudslide, special regulations also announced through No. 59 File [2010] and No. 107 File [2010] of MOF & SAT; such that under certain conditions, as long as individuals could obtain relevant donation records, not only could they complete the tax deductions in full for the month, they could moreover also deduct in full for the amount over the deduction limit during the remaining months of the year. In terms of approval for foundations and social groups authorised to have donations to them deducted for an individuals' tax calculations, according to a series of regulations of different provinces, documents of requirements and lists would vary from year to year. Through this variability, the tax deduction policy could be viewed as an important means by the government to encourage personal charitable donations, with these policies also able to be adjusted according to the actual circumstances.

1.3 Research Objectives and Methodology

According to the research of Ding Meidong (2008) and Qu Shunlan (2011), the existing personal charitable donations deduction ratio of 30% is relatively low, and it is thus advisable for that ratio to be increased so as to encourage individual donations. In research by Zheng Nan and Zhang Chao (2008), whilst an attempt had been done for education level to be used to describe charity consciousness, the variable has been eliminated due to its linear correlation to income level. We think that at this stage, it is far more important to find a way to educate the public and for the tax deduction policy to be used than to strengthen the policy itself; as the education level of taxpayers do reflect on the comprehension and overall implementation of the existing tax deductions policy to some extent. Additionally, the Engels coefficient of taxpayers also has a great influence on tax deduction policies; whereas factors like the taxpayers' political status, neighbourhood relations, expectations for future economic situation and income gap could also affect

taxpayers' decisions on donations. Drawing lessons from domestic and foreign studies (Martin Feldstein and Amy Taylor (1976); Cao He (2007) etc.) on the influence of individual income tax rate on personal charitable donations by means of price elasticity, we could thus view the influence of individual income tax rate on personal charitable donations in this paper as the result of effects from both price and income. We can then group the samples based on income level in order to observe the changing influence of tax ratio under different conditions.

In this section, on the basis of a literature review of former research, we can put forward a theoretical and research hypothesis, and could also undertake data processing and the task of describing variables. By empirical analysis of measurements, we can then study the influence of individual income tax on personal charitable donations, before then putting forward some policy suggestions.

II. Review on Research in China and Abroad

2.1 Review of Foreign Literature

Empirical analysis methodologies dominate in foreign research fields. Martin Feldstein and Amy Taylor (1976)⁴ and Gerald Auten, Holger Sieg, and Charles Clotfelter⁵ have studied the income elasticity of personal charitable donations and the tax price elasticity through construction of a model. Grouping the samples based on income level, they have empirically proved the influence of price elasticity of different income levels on personal charitable donations and found that the price elasticity is relatively high no matter the income level. Michael J. Boskin and Martin Feldstein (1977)⁶ have mainly focused on personal charitable donations from the middle-income and the low-income groups, firstly processing the data of individuals with no donations, before categorising them into corresponding groups to calculate the price elasticity of tax. Amy Dunbar and John Phillips⁷ has rather taken two steps to reveal the influence of tax on individual donations and the donations' extent – via Probit regression and OLS regression. These pieces of research have great significance in referencing of their methodologies, though the data is rather out-of-date, and is also not representative of the status quo in China.

2.2 Review of Domestic Literature

Studies from domestic scholars on personal charitable donations and individual income tax have involved both theoretical research and empirical research through constructions of models. In terms of theoretical research, Hu Junkun and Yang Gang⁸

⁴ Feldstein, M., & Taylor, A. 'The income tax and charitable contributions'. (1976) *Econometrica: Journal of the Econometric Society*, 1201-1222.

⁵ Austen G, Sieg H & Clotfelter C, 'Charitable Giving, Income, and Taxes: An Analysis of Panel Data', (2002) *American Economic Review* 371-382.

⁶ Boskin M & Feldstein M, 'Effects of the Charitable Donation on Contributions by Low Income and Middle Income Households: Evidence from the National Survey of Philanthropy', (1977) *The Review of Economics and Statistics* 351-354.

⁷ Dunbar A & Phillips J, 'The Effect on Tax Policy on Charitable Contributions: the Case of Nonitemising Taxpayers', (1977) *Journal of the American Taxation Association* 1-20.

⁸ 胡俊坤,杨刚,《捐赠的个人所得税筹划》Hu J & Yang G, 'Personal Income Tax Planning for Donations', (2004) 3 *Shui Shou Zheng Na* 42-43.

have focused on finding an optimal way of making donations so that individuals could not only maximise the protection of their own interest, but also achieve charitable targets under current individual income tax policies. Ding Meidong⁹ have analysed tax incentive policies for personal charitable donations. By constructing an economic model, she derived the point of equilibrium between tax deduction and tax credit, drawing the conclusion from this that tax deduction policies would be the policy most suitable for China's circumstances. Qu Shunlan and Zhang Li¹⁰ have studied problems in tax incentive policies relating to personal charitable donations, such as a scattering of policies in different areas, and the limited incentive effects which existing policies have – also putting forward some suggestions. Li Jie,¹¹ after a comparison of the incentive policies for charity between China and other nations like the United States, Japan, and the United Kingdom, has also proposed policy recommendations for improvements to tax policies for personal charitable donations.

Within the Chinese domestic literature, empirical research are still relatively rare. Zhang Jinmei et al., based on a survey of 811 residents from 14 cities and rural areas in the Liaoning province, have analysed the influence of demographic factors (including age, income, occupation, political status, education level, religion and marital status) on individuals' daily and special donations¹². This research has found that factors like education, occupation, income and political status had significant influence on personal charitable donations for both urban and rural residents, advising that policymakers should, such, tailor their policies to local and personal conditions. Zhang Nan and Zhang Chao (2008), through the questionnaire survey to the nine districts of Chengdu, have established the explanatory variables of personal income, cost of donations, tax incentives (i.e., tax deductions that donors be compensated the tax amount), government spending, media influence, the proportion of on-campus students, and the extent of local minimum subsistence population in analysis of the various influence factors of affect individual donations. Within this study, it was found that spending on personal donations has had a significant positive correlation with personal income and tax incentives have while having a significant negative correlation with the cost of donations and the proportion of the minimum subsistence population; though without much correlation to government spending.

2.3 Contributions and Significance of this Study

This paper would study the price and income effects of the existing tax rules surrounding personal charitable donations, empirically analyse the strengths and the weaknesses of these effects, and to propose policy suggestions with a focus on the incentive goals of the tax deductions system. In this study, by applying the 2011 China labour force survey data released in 2012 for empirical research and analyses,

⁹ 丁美东,《个人慈善捐赠的税收激励分析与政策思考》,Ding M, 'Policy Thinking and Analysis Surrounding Personal Charitable Donations Tax Incentives', (2008) 7 *Contemporary Finance & Economics* 29-33.

¹⁰ 曲顺兰,张莉.《税收调节收入分配:对个人慈善捐赠的激励》,Qu S & Zhang L, 'Income Redistribution Through Taxation: Incentive Impacts to Individual Charitable Donations', (2011) 3 *Taxation Research* 33-35.

¹¹ 李节,《促进我国慈善捐赠的税收政策研究》,Li J, 'Research on tax policy of promoting charitable donation in China', (2011) Master Thesis, Southwest University of Finance and Economics.

¹² 张进美,刘武,刘天翠,《城乡居民个人慈善捐赠行为差异实证研究——以辽宁省为例》,Zhang J, Liu W & Liu T, 'Empirical Differences Between Urban and Rural Residents Regarding Personal Charitable Donations – Example from Liaoning Province', (2013) 4 *Social Security Studies* 79-85.

the regional limitations of the data in the original study could firstly be mitigated. Secondly, through analyses of China's 2011 labour force survey data collected before the personal income tax reform, an evaluation of the reform could also be done. Thirdly, with this chapter looking into the income tax component of taxes to the individual and its relationship to personal charitable donations, a regression analysis could be constructed; analysing the components of the individual income level and the societal income inequality. The policy implications of these components could also be ascertained through interactions in regression. Such, this study could be seen as having a meaningful practical significance.

III. Theoretical Analysis and Research Hypotheses

3.1 The Relationship Between Tax Deduction Policies and the Behaviour of Donating

Starting in 2007, all individual charitable donations meeting the government criteria, as long as it is not more than 30% of the amount of taxable income, could be deducted before personal income tax calculations. These tax deductions could reduce the monetary cost of personal charitable donations, and could have an effective, stimulatory effect on donation behaviours. Premised upon on the national survey data and analyses, we could put forward hypothesis 1:

H1: The greater the extent of the individual income tax deductions, the stronger the stimulatory effect this would have upon individual charitable donations.

To some extent, the education level of individuals could be used to measure two indicators, the charity consciousness of individuals and the ability to accept the rules as laid by law. This is because whereas charity consciousness, as an instinctive, intrinsic, altruistic motivation would not affect the relationship between tax discounts and donation behaviours; the ability to accurately understand the legal system and to be in adherence to the bureaucratic procedures for tax deductions would rather seriously influence the relationship between tax deductions and one's behaviours of donation. Such, hypothesis 2 could hereby be put forward:

H2: A higher level of education will strengthen the influence of tax deduction policies on the donation behaviours.

Whilst tax burdens could be reflective, to a certain extent, of the families' financial pressures and the cost of donations, it does not fully consider the variability in education levels or in overall abilities of the taxpayers who enjoy the same amount of income. Therefore, the Engels coefficient should be introduced to measure the actual burdens of the family. This is because in general, when the family financial burdens are heavier, they would not necessarily have the time or energy to understand the relevant policies surrounding the tax deductions; with this thus weakening their ability to support charity. For low-income groups, this inhibitory effect would be more significant. From this, hypothesis 3 could be proposed:

H3: An increase in the Engels coefficient would correspond to a greater inhibitory effect to the ability for tax deductions to stimulate charitable donations.

3.2 The Individuals' Effective Tax Rate and their Donation Behaviours

Previous scholars have studied the tax price effect of individuals' charitable donations mainly through the marginal tax rate; namely when the individual marginal tax rate is t , and when its cost of donations is $1 - t$. When tax rate rises, the price of the donations (both monetary and opportunity costs) will drop, which could stimulate individual donations due to the positive correlation between the marginal tax rate and the extent of donations. In this section, the variable of the effective tax rate, the ratio between the tax of the individual and their taxable income, is used to study this effect. Theoretically, from one perspective, the rise of the effective tax rate would imply the rise in marginal tax rate and an increase in the tax burden of the individual. Because of this effect on income, an individuals' charitable donations would decrease. However, from another perspective, the higher the effective tax rate also correlates with a lower price for donations, which would rather stimulate individuals' charitable donations.

Despite these conflicting theories, we believe that personal income is positively correlated to the effective tax rate, where an increase in the effective tax rate would imply a the higher personal income, thus indicating a stronger ability to donate. Despite the income and price effects, the total amount of donations would still be increased. On this basis, hypothesis 4 could be proposed:

H4: The effective tax rate of personal wages will have a positive correlation to individual donation behaviours.

3.3 Income Factors and Donation Behaviours

For those of different income levels, with their differing abilities and motivations for charitable donations, the degree of influence of the tax deductions system and the effective tax rate on the extent of donations would also vary as a result. However, because of the effect of the progressive taxation system, where both the effective tax rate and the tax payable would increase more significantly for higher income earners; the income effect of donation would be of more importance, with the cost of donations being of lesser significance. Therefore, the tax cuts within a tax deductions system will be more effective to the higher income population. Correspondingly, with the lesser influence of tax and tax rate increases for the lower income population, the effect yielded by the cost of donations could also exceed the effects from income. Such, with the lower payment of individual income tax of the low income, the influence of the tax deductions system in stimulating charitable donations will also be smaller. Based on above analysis, hypothesis 5 could be proposed:

H5: For the higher income population, the influence of effective tax rates and personal charitable donations will be relatively weak, while the effects of any tax deductions system in influencing charitable donations will rather strong. For the lower income population, the relative strength of these influences would rather be reversed instead.

In a society with high income inequality, there will be a greater need for the higher income groups to support the lower-income, more vulnerable population. The need for charitable donations will also increase. In this environment, the progressive taxation system will make high income earners more likely to manage individual income tax through forms like charitable donations; with this strengthening the advantages of a tax deductions system will be more obvious. For a low income-gap society, since the difference between individuals' tax burden is smaller, the policy emphasis towards tax deductions will also be lower, with this decreasing the incentive effect. Based on this, hypothesis 6 could be conjectured:

H6: In a society with greater income inequality, the stimulatory influence of tax deductions to individual charitable donations would be more significant.

IV. The Selection of Samples, Construction of Models, and Description of Variables

4.1 Sample Selection

The empirical data used in this section have been gathered from the 2011 China Labour force survey conducted by Center for Social Survey at Sun Yat-sen University in 2012. The scope of this survey have included 29 provinces, municipalities, and autonomous regions in China with the exception of Hainan, Tibet, Taiwan, and the Hong Kong and Macao Special Administrative Regions. From this set of data, the variables of the charitable donations of labour, annual total post-tax income, education level of respondents, family's expenditure on food, total household expenditure, political views, neighbourhood relations and various other information have been specifically selected. Of all respondents, only the data from those in the labour force whose income from wages and salaries is equal to total income would be kept for convenience in the tax calculation process. After this process, following the removal of data points where certain details cannot be ascertained, a total of 877 pieces of personal data from those in the labour force, whom in 2011 had charitable donations experience and other information completely matching, have been obtained. Of these individuals, 207 have made their donations through the provincial charity associations. whilst the remaining 670 individuals have donated through other associations.

In order to better conduct research, calculations have been done to the data collected. First, through the use of the individual annual post-tax income alongside the individual income tax (wage and salary tax), the individuals' pre-tax income could firstly be calculated. Based on this, the individual effective tax rate and the extent of

their tax deductions could also be obtained. Then, using data on families' expenditure on food and their total household expenditure, the Engle coefficient of the families could then be found, in reflection of the actual tax burden of the individual. Third, through observations of the individuals' political views, the effect of their beliefs towards the extent of charitable donations could be studied. Fourth, using personal evaluations of their neighbourhood relations, the influence of one's living environment on their degree of charitable donations could also be observed. Last, through observations on the effects of education level towards one's charitable donations and their use as a proxy variable, the elements of the tax deductions policy and the individuals' tax deduction could better be understood.

4.2 The Assumptions

1. That all charitable donations made by individuals within the sampled data towards provincial charity associations are already tax deducted, whereas donations to other fields are not.

As official charity organisations founded by the Provincial Departments of Civil Affairs, all of the provincial-level charity associations have obtained the qualifications necessary to allow for tax deductions in 2011. Since 2006 and Wang Zhenyao's donation of 500 yuan as an experiment, these provincial charity associations have also been given the responsibility to promote the individual charitable donations deductions policy; such that for all personal charitable donations made through these charity associations, special invoices would be sent to the individual to facilitate tax deductions. Thus, a reasonable assumption could be made that the 207 donations to the provincial-level charity associations have all been tax deducted as per the procedures prescribed. However, for donations to other charity associations, as many charity associations have not yet obtained the qualification for tax deductions, with a random survey also showing that most donors have not understood the tax preferential policy nor have had deductions to their individual income tax; the remaining 670 charity donations to other charity associations are all assumed to not have been tax deducted.

2. That the total income of individual samples is simply income from their wage and salaries.

During the sample selection process, as only the individual samples whose income from wage and salaries income is equivalent to total income have been selected, this paper would such only study the charitable donations of the working-class; with consideration only to their income, income taxes, and the effective tax rate.

3. No other fees deducted except the deductible level of standard taxable income.

Since individual income data are is from wage and salaries income before the tax reform of individual income tax, the expense deduction standard is 2000 Yuan with no other expense deduction.

4. That the donation behaviours and the tax deduction process is as below:

Since the wage tax is withheld by companies and work units, tax deduction invoices provided to the individual would need to be provided to the financial departments of these organisations and work units for a uniform deduction of individual income tax.

As such, the decision-making process of personal charitable donations is as follows: the individual firstly decides to whether to donate to charity, taking into account the amount of donations based on their post-tax income, the effective tax rate of their wage and salaries income, and the extent of tax deductions which they could obtain following their donation. Then, after a decision is made and donations provided, the individual would then take the deductible invoices to the relevant financial departments of the work units for these deductions to be processed.

Therefore, in this paper, the individual income tax calculated based on the post-tax income would simply be the tax rate prior to any tax deductions. The effective tax rate and the tax deductions for sampled data have also been calculated using on the following methodology.

(1) Using the income tax and tax rates table and quick deductions number, the individual income tax withheld prior to personal charitable donations and the individuals' pre-tax income could be calculated.

(2) Through comparing the extent of personal charitable donations with the deductions limit of 30% of the taxable income amount (*pre-tax income – 2000*), the pre-tax deductions amount could be obtained;

(3) Using the formulae of: $(pre-tax\ income - 2000\ yuan - deductible\ amount) \times applicable\ tax\ rate - quick\ deductions\ number$; the actual tax payable following the charitable donation could be derived.

(4) Finally, through the equation where:

$$\text{the effective tax rate of personal income} = \frac{\text{the individual income tax withheld prior to personal charitable donations}}{\text{pre-tax income}};$$

the individual tax discount (tax rebate) could be calculated as the following:

$$\text{Individual tax discount (or tax rebate)} = \text{the individual income tax withheld prior to personal charitable donations} - \text{the actual tax paid}$$

4.3 Specification of Constructed Model and Explanation of Variables Used

4.3.1 Model specification

In order to study the relationship between the individual charitable donations and the individual income tax, the individual charitable donations amount has been chosen as the explained variable; using a series of explanatory variables in measurement of the charity consciousness, the costs of donations, and the extent of motivation for charitable donations. The basic regression model for this study has been set as follows:

$$\ln(charity) = \alpha + \beta_1 * taxrate + \beta_2 * taxdiscount + \beta_3 * educ + \beta_4 * engel + \beta_5 * status + \beta_6 * relation + \beta_7 * expect + \beta_8 * Idis + \varepsilon (1)$$

Within this equation, $\ln(charity)$ represents the amount of the individual charitable donation; $taxrate$ represents the effective tax rate of the individuals' income based on wage and salaries; $taxdiscount$ represents the tax discount enjoyed from deductions as a result of personal charitable donations. Additionally, whereas $Idis$ is simply a binary variable showing whether an individual have had tax deductions, (whether the donations have gone to eligible provincial-level charity associations); $Educ$ would rather represent the education level of the respondents; and with $Engel$ representing the family financial burden of individuals beyond individual taxes overall. The variable of $status$ categorises individuals based on political affiliations, which is divided into two categories: either 'no political affiliation' or 'members of either the communist party or other democratic parties'. Finally, the variables of $expect$ represents the expectations of the individuals of their economic status in the next five years; whereas $relation$ represents the individuals' self-assessment of the relationship between themselves and those of their surrounding neighbourhood.

After testing, the above model does not have the issues of multicollinearity and heteroscedasticity; and, as such, the model could be used for empirical research on the relationship between the effective income tax rate, the tax deductions for personal charitable donations, and overall extent of charitable donations. However, in this model, as the effective tax rate is calculated based on the extent of individual tax payable (before donations) and the taxable income; the variable of income level could not be used as an explanatory variable in order to prevent issues of multicollinearity.

4.3.2 Explanation of Variables Used

This paper mainly studies the tax deductions surrounding personal charitable donations in China, and the impacts which the effective income tax rate would have towards the extent of charitable donations. An explanation of the selection of indicators are as follows:

Tax discount: the amount of tax discount which is measured by the difference in the extent of tax before deduction, contrasting the figure following tax deduction of the donations. This index measures the incentive of the pre-tax deduction for charitable donations.

Idis: the binary variable showing whether there is an individual pre-tax deduction. For this variable, the value of the 207 individuals who have made personal donations to provincial-level charity associations have been set as 1, whereas the value of the 670 individuals who have made personal donations to other charity organisations are set as 0. This binary variable is set in order to reflect the relationship between the amount of the charitable donations and the eligibility for the charitable donations in question to be tax deductible. Additionally, as the tax discount through deductions could only exist when the individual charity donor meets governmental criteria for tax deductions. in order to prevent endogeneity within the model, the tax discount is stripped down to the influence of the binary variable toward the amount of charitable

donations – this done in order to accurately reflect the impacts of tax discount toward the amount of charitable donations.

Tax rate: the variable of the effective tax rate of individual payroll tax. For this, whilst the 2011 national labour questionnaire is a survey on post-tax income data, the withheld payroll taxes and pre-tax income could still be calculated as mentioned prior in this paper. This variable is chosen as, in reality, taxpayers would pay a greater attention to the proportion of their withholding tax in their income level prior to making decisions surrounding donations. As a result, the effective tax rate would be able to better reflect the decision-making process of the individuals' personal donations as compared to the marginal tax rate at large.

Educ: this reflects the education level of respondents. In this paper, this is operationalised into six categories. Those with an education level lower than a primary school would have the variable value set to 1; those with a primary school education (including home-schooling with a private tutor) would be set to 2; those with a junior high school education would be set to 3, whereas those with a high school, vocational high school, or a technical secondary school education would be set to 4. Students with a technical college degree would be set to 5, whereas those with an undergraduate degree, postgraduate degree, or a high qualification would be set to 6. This is because in this paper, not is the education level argued to correlate with the better personal qualities and a greater extent of a charity consciousness within the individual, it could also signify the individuals' better understanding and navigation of tax policies and legal documents. Anecdotally, individuals with a higher education would ultimately have a better ability to understand tax policy and a better execution of actions. Such, it is likely that they can better obtain tax incentives from their donations as a result.

Engel: the Engel coefficient is measured with using the "*family food consumption expenditure ÷ household consumption expenditure*" formula. This is important, as China's family planning policy has reduced the quantity of labour in a family. A change in the individual's familial financial burden as a result will also affect the behaviour of individuals in relations to donations. Such, the Engel coefficient could be used as a proxy variable representing family burdens.

Status: As a two-value variable, it measures individuals' political affiliations. The value of those within the Chinese Communist Party and other Democratic Parties are set as 1; whereas politically unaffiliated individual are set as 0. This is because in China, political status may reflect an individual's beliefs or values to a certain extent, which could have influence upon their donation behaviours.

Relation: this variable is derived from the individual self-assessment of the relationship between individuals within their neighbourhood. In the questionnaire, individuals could rank the neighbourhood relations from 1-10, with 10 being extremely harmonious while 1 indicates significant discord. As individuals all live in a community, the interpersonal relationships within the neighbourhood could have influence on an individual's charitable consciousness. Individuals with friendly relations to their neighbours may thus show a stronger charitable consciousness, and may be more likely to donate.

Expect: this is an individual self-assessment of their economic situation within the next 5 years. Those who expect their future financial situation to improve would be set as 1, whereas those with an expectation of economic deterioration will be set as 0. This is as personal charitable donations will also be affected by the expected outcomes of one's future financial circumstance. Anecdotally, those with positive future expectations may have a greater motivation to donate. The description of variable, as above, is summarised in table 2:

Table 2 Variable description

Variable	Name	Label
Ln(charity)	The amount of personal donation	Personal charitable donations
Tax discount	Tax incentives	The incentive effect of pre-Tax Deduction Policy
Idis	Eligibility for tax deductions	yes =1, no =0
Tax rate	Effective tax rate of individual payroll tax	Personal payroll tax/personal income (percentage).
Engel	the Engel coefficient	Measuring personal family burden
Educ	education level of respondents	6 equal parts
Status	personal political status	politically unaffiliated = 0, Communist Party members or the Democratic Party members = 1
Relation	self-evaluation of the interpersonal relationships within the neighbourhood	10 equal parts
Expect	Individual expectation of their financial situation in the next 5 years	Finances to improve = 1, Finances to deteriorate = 0

V. Empirical Research

5.1 Descriptive statistical analysis

In order to eliminate the influence of the extremum, a winsorising process has been done on the continuous variables; where all data below 1% and above 99% has been set to their corresponding percentiles. A descriptive statistical analysis has also done to the overall sample of 877 individuals alongside the tax-deducted sample 207 individuals. The results are shown in Tables 3 and 4.

From the statistical results of the overall sample, the average donation amount within the sample of 877 individuals has been about 450 yuan, with the largest donation being 5000 yuan. However, the data also shows a significant statistical spread, with the lowest donated amount being only 10 yuan. For the 207 individuals who have donated to the charities eligible for tax deductions, their average donation has been 1038 yuan, 2.3 times the amount of the overall average donation. Within the overall sample, the average effective tax rate has been 6%, which is close to the lowest tax rate of 5% (before the tax reform), with the highest rate of individuals within the sample being only 19%. Through this, it can be seen that whilst the overall tax burden of the working class in the sample is relatively low, donations to charity associations which are eligible for tax discounts have still been significantly higher than donations to any other charities ineligible under the tax discount policies.

Through calculations of the Engels coefficient, the familial financial burden of 877 individuals could also be seen, with this coefficient seeing significant variance between individuals. The lowest result here has been 9%, whereas the highest amount has reached 91%; though the average of all coefficients remains around 41%, a result consistent with China's overall societal development at a relatively well-off level. Regarding the demographics of the 877 working-class individuals sampled; their education level remains moderate, with them generally having a junior high school or a high school education, though the 207 individuals who have donated to the provincial-level charity associations eligible for tax discounts have rather had slightly higher education. The inter-personal relationships of the 877 sampled working-class people and their neighbours is also harmonious, though the proportion of Communist Party members and members of other democratic parties is small. Of the 877 people sampled, whilst there is largely a positive expectation towards their financial circumstances of the next five years, the 207 people who have donated to the charity associations eligible for tax deductions have rather held even more optimistic financial expectations.

Table 3 The variables describing statistical results of the overall sample

Variable	Obs	Mean	Std. Dev.	Min	Max
Charity	877	454.51	743.81	10.00	5000.00
Tax rate	877	0.06	0.04	0.00	0.19
Tax discount	877	5.66	17.30	0.00	103.43
Engel	877	0.47	0.19	0.09	0.91

Educ	877	3.86	1.52	1.00	6.00
Expect	877	0.68	0.47	0.00	1.00
Relation	877	6.88	2.00	1.00	10.00
Idis	877	0.24	0.42	0.00	1.00
Status	877	0.24	0.43	0.00	1.00

Table 4 The variables describing statistical results of the deductible sample¹³

Variable	Obs	Mean	Std. Dev.	Min	Max
Charity	207	1038.96	1920.24	10.00	10000.00
Tax rate	207	0.06	0.05	0.00	0.21
Tax discount	207	28.84	47.83	0.08	266.67
Engel	207	0.47	0.18	0.10	0.87
Educ	207	4.03	1.51	1.00	6.00
Expect	207	0.89	0.32	0.00	1.00
Relation	207	6.97	2.12	1.00	10.00
Status	207	0.27	0.45	0.00	1.00

Using the data of the variables, a correlational analysis has also been done,; the results shown in Table 5. From the data shown in the table, the correlation between the explanatory variables and explained variables are statistically significant to 1%, with no significant or discernible multicollinearity between the variables. From the correlation matrix, whereas the Engels coefficient has a prominent negative correlation with the extent of individual donations; the effective tax rate, the extent of tax incentives and other variables have all shown a significant positive correlation

¹³ According to the United Nations Food and Agriculture Organization of the standard, Engel coefficient more than 59% is poverty, 50-59% is the Food and Clothing, 40-50% is the well-off, 30-40% is rich, less than 30% is the richest.

with the amount of personal charitable donations, and with these symbols also being in line with initial expectations.

Table 5 Correlation coefficient matrix

	Ln (charity)	Tax rate	Tax discount	Engel	Educ	Expect	Relat ion	Statu s	Idis
Ln (charity)	1.000								
Tax rate	.337* **	1.000							
Tax discount	.290* **	.142* **	1.000						
Engel	-.336 ***	-.250* **	-.141***	1.000					
Educ	.565* **	.413* **	.145***	-.218* **	1.00 0				
Expect	.164* **	.089* **	-.012	-.137* **	.063 *	1.000			
Relation	.381* **	.224* **	.095***	-.122* **	.318 ***	.115** *	1.00 0		
Status	.280* **	.104* **	.081**	-.0310	.282 ***	.084**	.095 ***	1.00 0	
Idis	.150* **	-.010	.589***	.0160	.060 *	-.362** *	.026 0	.037 0	1.0 00

5.2 Empirical Analysis of Tax Policies and Donation Behaviours

The impact of tax policy on charitable donations is shown in Table 6. From the overall circumstances of the 877 people sampled, whether the subject of the donations is eligible for tax deductions, and whether the individual could deduct their donations from taxable income has had a significant positive correlation to the amount of individual donations. This shows the tax deduction policies have been a prominent consideration for in the decision-making process for individual donations. Within the 207 people sampled who have donated to charity associations eligible for tax deductions, the amount of individual tax incentives received and the extent of their individual donations are also significantly, positively correlated to a statistical significance of 10%. Thus, it could be seen that tax deduction policies would have a significant impact on the individual's donation behaviour and the amount of these donations given.

Additionally, with the effective tax rate of the 877 individuals sampled also having a significantly positive correlation with the amount of donations to a 10% significance; it could also be seen that individuals who have a higher income would overall contribute more to charitable donations despite their heavier burden of tax. This verifies hypothesis four, showing that the effective tax rate of individuals has a positive correlation with donation behaviours.

Comparing the individuals who have donated to charities eligible for tax deductions to those donating to charities ineligible for tax deductions, it could be found that the factor of effective tax rate for the latter would have a smaller effect on the amount of the donation to a greater statistical significance. This is because with an inability to enjoy the tax deductions, the impacts of the effective tax rate on individual donations would be reduced; though due to effective tax rate being the only factor affecting the amount of tax payable, it would be of greater significance. At the same time, under the circumstance when the individuals' donations are ineligible for tax incentives, their motivations for donations would be derived to a greater extent from their charitable consciousness, personal preference, and other individual factors. This could be seen from the regression results of the relationship between the political affiliation, inter-personal relationships within one's neighbourhood, the extent of attained education, and the amount of donations; which shows that these individual factors do have a greater impact on individual donations ineligible for tax deductions.

Table 6 The regression results of tax policy and donation behaviour

	Population	Pre-tax deductible individual	Nontax deductible individual
Tax discount	0.0091*** (0.0024)	0.0017* (0.0016)	—
Tax rate	1.5566* (0.8114)	1.6402* (1.5835)	1.3522** (0.9297)
Educ	0.3208*** (0.0249)	0.2763*** (0.0570)	0.3260*** (0.0270)
Engel	-1.2569*** (0.1810)	-3.0932*** (0.4520)	-0.8606*** (0.1922)
Expect	0.4592*** (0.1136)	1.0238*** (0.1689)	0.2533 (0.1620)
Relation	0.1207*** (0.0170)	0.0777** (0.0368)	0.1216*** (0.1879)
Status	0.3629***	0.1837	0.3120***

	(0.0780)	(0.1690)	(0.0870)
Idis	0.2714*** (0.1041)	—	—
N	877	207	670
Robust	Y	Y	Y

5.3 The impact analysis factors of income

5.3.1 Internal factors - grouped by income

After grouping the population using the median of income level of individuals, a regression analysis has been done, with the results shown in Table 7. From this, it can be seen that whilst the influence of the effective tax rate is greater for the lower income population, the effects of tax deductions for the lower income population in incentivisation of donations is rather less prominent and largely insignificant. Contrastingly, the donation amounts of the higher income population is more influenced by the extent of tax discounts, as opposed to the effective tax rate. The reason is that for the lower income demographic, the extent of their donations is to a greater extent affected by their amount of disposable income and their tax burdens; such that a change in effective tax rates in raising of individual income levels would also increase the extent of charitable donations. For the higher income demographic, with a greater awareness for tax planning, the ability to obtain tax deductions would rather be a primary incentive for donations; as under a progressive taxation system, an increase in the effective tax rate would elevate one's tax burden, with the subsequent income effect of tax only serving to curtail one's incentivised willingness for charitable donations. This is accordant to hypothesis 5 – where for the higher income population, the influence of effective tax rates and personal charitable donations will be relatively weak, while the effects of any tax deductions system in influencing charitable donations will rather strong. Contrastingly, for the lower income population, the relative strength of these influences would rather be reversed instead.

Table 7 Regression results based on income level grouping

	The overall	The high income	The low income
Tax discount	0.0091*** (0.0024)	0.0078*** (0.0023)	0.0006 (0.0044)
Tax rate	1.5566* (0.8114)	2.1266* (1.5222)	5.8084** (2.4822)
Educ	0.3208*** (0.0249)	0.3049*** (0.0348)	0.3404*** (0.0351)

Engel	-1.2569*** (0.1810)	-1.3216*** (0.2710)	-1.1984*** (0.2443)
Expect	0.4592*** (0.1136)	0.3674*** (0.1696)	0.5557*** (0.1627)
Relation	0.1207*** (0.0170)	0.0687** (0.0267)	0.1470*** (0.0266)
Status	0.3629*** (0.0780)	0.3570*** (0.1027)	0.3564*** (0.1193)
Idis	0.2714*** (0.1041)	0.3988*** (0.1348)	0.3950* (0.1581)
N	877	406	471
Robust	Y	Y	Y

5.3.2 External factors, grouped by regional income gap

To further study the effect of the external environment factors on the individual charitable donations, the individual income gap in different regions is calculated in demonstration of its impact on charitable donations. To allow the societal income gap to be simulated as much as possible, the income gap figures are calculated based on the sampled data of the 877 individuals, grouped based on their provincial demographics. The specific calculation formula for the income gap of each province is as below:

$$\frac{(\text{The highest individual income sampled} - \text{The lowest individual income sampled})}{\text{The highest individual income sampled}}$$

In terms of results, this equation would produce figures from 0 to 1, with 1 representing absolute inequality, and 0 denoting absolute equality. Then, based on the median figures of income inequality calculated, the 877 people could then be grouped for respective regression analyses, the results of which are shown in Table 8.

From this, it is shown that in regions with greater income inequality, the influence of tax deduction and discount policies, and the effects from the effective tax rate are both prominent and statistically significant, whereas for individuals in regions of lower personal income inequality, none of tax deduction policies, tax incentives, nor effective tax rate has had a significant effect towards the extent of individual donations. This verifies hypothesis 6 – that in a society with greater income inequality, the stimulatory influence of tax deductions to individual charitable donations would be more significant.

This is because in areas of lower income gap, the demand of charity giving is smaller due to the smaller financial differences between the rich and poor. Additionally, as

the personal income gap would be smaller, the inter-personal differences in personal income tax burdens would also be similarly decreased; thus subduing the incentive effects of any tax policy stimulus for charitable donations as donations in these areas would likely be more affected by non-tax factors such as charitable consciousness. Contrastingly, in regions with a larger income gap, with greater income and wealth inequality and greater demand for charity, and with the government's greater priority on meeting local and regional charitable needs, the incentive effects from tax policy would ultimately exert a larger stimulatory influence towards charitable donations.

Table 8 The regression results according to the grouped income gap of different provinces

	The overall	The high-income gap	The low-income gap
Tax discount	0.0091*** (0.0024)	0.0271*** (0.0044)	0.0021 (0.0018)
Tax rate	1.5566* (0.8114)	1.3610** (0.9483)	1.6333 (1.5034)
Educ	0.3208*** (0.0249)	0.3231*** (0.0288)	0.2984*** (0.0488)
Engel	-1.2569*** (0.1810)	-1.069*** (0.2174)	-1.5743*** (0.3236)
Expect	0.4592*** (0.1136)	0.5200*** (0.1340)	0.3336 (0.2164)
Relation	0.1207*** (0.0170)	0.1287*** (0.0196)	0.1121*** (0.0332)
Status	0.3629*** (0.0780)	0.2850*** (0.0958)	0.5387*** (0.1324)
Idis	0.2714*** (0.1041)	0.2502* (0.1337)	0.1900 (0.1520)
N	877	241	636
Robust	Y	Y	Y

5.4 The regression analysis of the interaction item of the influencing factors

In this section, the relationship between the education levels, the Engels coefficient, tax discount, and the charitable donations on individuals will be explored through adding interactions in regression for the variables of education levels, the Engels coefficient, and the tax incentives into the original model; before analysing the sampled results following its categorisation into high and low income groups. In order to reduce collinearity in modelling, a process of zero-centring has been done to the Engel coefficient and the tax discount. In the following formula, *Educ_dis* and *eng_dis* would respectively represent the interactions in regression between the level of education and tax incentives, and interactions in regression between the Engel coefficient and tax incentives overall. The *X* as follows would rather denote the remaining explanatory variables in the original equation.

$$\ln(\text{charity}) = \alpha + \beta_1 * \text{taxdiscount} + \beta_2 * \text{educ} + \beta_3 * \text{educ_dis} + \beta_4 X + \varepsilon \quad (2)$$

$$\ln(\text{charity}) = \alpha + \beta_1 * \text{taxdiscount} + \beta_2 * \text{engel} + \beta_3 * \text{eng_dis} + \beta_4 X + \varepsilon \quad (3)$$

From the two sets of results below, it is undoubted that the tax discounts policy has stimulating effect on charity, as a result consistent with previous hypotheses; though the effects as caused by external factors would also serve to carry differing policy implications.

5.4.1 The influence of education level on tax discount and charitable donation behaviours

The statistical results of the interactions in regression analysis between education levels and tax discounts are shown in Table 9. Such, it is observable that education levels do indeed influence charitable behaviour with the tax discount policies, this attributable to the individuals' abilities in comprehension of tax laws and policies, but moreover also a better execution of their charitable actions. From the overall results measured, higher levels of education do have an incentive effect in the promotion of tax deductions for individual charitable donations to a statistical significance of 1%. This is consistent with hypothesis 2 of this paper. Additionally, by comparing the results of the high and low income demographics, it could also be found that even for the low income groups, the coefficient of interactions in regression is larger and more statistically significant, revealing that higher education levels, even should they be of lower income, would lead to greater attention towards the incentive effects of tax deductions policies for charitable donations.

With the deepening reform of the tax laws in China, policies surrounding tax deduction policy and management would be in constant change. As tax policy is highly specialised and professional field, and with the requirements and procedures of pre-tax deduction being also relatively cumbersome; individuals with higher level of education under this environment would be able to not only better understand and comprehend the latest tax incentive measures and the methods and process to obtain these benefits, but could also better obtain tax deductions in accordance with the legal requirements as a result.

Table 9 The regression results of level of education and tax discount interaction

	The overall	The high income	The low income
Tax discount	0.0067** (0.0027)	0.0066*** (0.0024)	0.0013 (0.0049)
Educ	0.3239*** (0.0249)	0.3092*** (0.0348)	0.3407*** (0.0352)
Educ_dis	0.0027** (0.0013)	0.0020 (0.0013)	0.0080** (0.0023)
Taxrate	1.5397*** (0.7985)	2.0220 (1.4800)	5.7522*** (2.4898)
Engel	-1.2225*** (0.1813)	-1.2918*** (0.2714)	-1.1907*** (0.2455)
Expect	0.4752*** (0.1136)	0.3822*** (0.1696)	0.5577*** (0.1630)
Relation	0.1189*** (0.0170)	0.0668** (0.0267)	0.1465*** (0.0227)
Status	0.3619*** (0.07786)	0.3355*** (0.1026)	0.3594*** (0.1197)
Idis	0.2919*** (0.1043)	0.4127*** (0.1349)	0.4008** (0.1592)
N	877	406	560
Robust	Y	Y	Y

5.4.2 Influence of Engel coefficient on the relationship between tax discount and charitable donations

The results of the interactions in regression analysis on Engels coefficient and tax preferential are shown in table 10 below. As evident from these results overall, a higher Engel coefficient will hinder the effectiveness of the incentives from preferential tax policies on donations, this being statistically significant to 1%. However, following categorisations based on income in measuring of this correlation, it could rather be observed of the lack of any significant correlation between the Engels coefficient for the high income demographic, whereas the aforementioned relationship of the Engels coefficient is rather maintained for the low income groups, statistically significant to 5%.

This is because the Engels coefficient measures the financial burden from one's household expenditures. Such, should the familial financial burden increase on the individual, not only would their ability to provide charitable donations decrease overall, there would further also be a reduction in time and energy able to be spent on understanding and actioning upon the tax deduction policies. For the lower income groups, the influence of these two factors will only be intensified; whereas for the higher income earners, even in light of a higher Engel coefficient and a heavier familial financial burden, it is likely for them to still retain the ability and disposable income to donate to charity, to capitalise on the incentive tax policies. This confirms hypothesis 3 as outlined in this paper.

Table 10 Regression results of Engel coefficient and tax discount interaction

	The overall	The high income	The low income
Tax discount	0.0051** (0.0026)	0.0060** (0.0029)	0.0019 (0.0044)
Engel	-1.3011*** (0.1801)	-1.3576*** (0.2737)	-1.2130*** (0.2430)
eng_dis	-0.0363*** (0.0099)	-0.0109 (0.0110)	-0.0412** (0.0167)
Tax rate	1.4257* (0.8064)	1.9936 (1.4848)	5.8470** (2.4687)
Educ	0.3182*** (0.0247)	0.3038**** (0.0348)	0.3327*** (0.0351)
Expect	0.4690*** (0.1129)	0.3644** (0.1696)	0.5408*** (0.1620)
Relation	0.1172*** (0.0169)	0.0665** (0.0268)	0.1432*** (0.0225)
Status	0.3448*** (0.0776)	0.3551*** (0.1028)	0.3540*** (0.1186)
Idis	0.3026*** (0.1037)	0.4263*** (0.1376)	0.3821** (0.1574)
N	877	406	471
Robust	Y	Y	Y

VI. Conclusion and Discussion

This paper has used the data of the survey on labour force in 29 provinces and autonomous regions of China in 2011, as conducted by the Centre for Social Survey at Sun Yat-Sen University in 2012. Through data analyses, this paper has studied the incentive policies surrounding personal income tax and its impact on the individual charitable donations; particularly focusing on the impact of the 3 factors of tax deductions policy, tax discounts, and effective tax rate of wage income.

The study has found that, overall, individual income tax discount policies could serve as a stimulant to the individual charitable donations. Moreover, after a categorisation is done both in terms of income level and existing income inequality, the incentive effect of the tax preferential policy is highlighted – both in high-income groups, but also in high income inequality societies. Besides this, it is also found through regression by interaction analyses that the education level and Engels coefficient of the individual can also have remarkable influence on the effect of the tax incentives. This is because with an improvement in education levels, individuals would be able to have a deeper understanding of taxation law, be able to better action in alignment with tax deduction procedures, thus amplifying the impact of the tax deduction system on personal charitable donations. This is especially important to the demographics both of the lower-income, but also of the relatively low education level groups. In terms of the Engels coefficient, it is found that the exacerbation of individual family burden marked by an increase in the Engel coefficient will such inhibit the effects of tax deductions, particularly in the lower-income demographic.

In this paper, differing to the indicator of the marginal tax rate adopted by scholars in the past, the individual effective tax rate of income is rather calculated and used to study its impact on the personal charitable donations. Though this impact also includes the encompasses the income and price effects of tax revenue, there remains a distinction in terms of definition to the marginal tax rate of previous scholars. In this paper, it is found that there has been a positive correlation between the amount of the personal charitable donations and the effective tax rate, with this impact more apparent in the lower-income demographic. However, within higher-income groups, due to an overall increase in tax burden due to the progressive taxation system in place, whilst the positive correlation between the effective tax rate and charitable donations is weakened in its strength; the impact of tax deduction policies in incentivising donations has rather been furthered. Besides this, it is found that the impacts of individual effective tax rate on charitable donations is also more apparent when there is significant charitable demand within society in environments with greater income inequality.

From this empirical study, it can be inferred that the individual income tax system and tax deductions policy have exerted great impact on the charitable donations. Thus, in terms of individual tax discounts for charitable donations, we believe that there is a need to either increase the extent of deductible income or to allow for charitable donations in excess of the deductible limit to continue to be deducted in subsequent years in the future. At the same time, not only should more charitable institutions be made eligible for donations to them to be tax deductible, the procedure for tax deductions should also be simplified in order to increase the convenience for donors to capitalise on tax deductions. This could encourage

taxpayers to make more charitable donations as a result. Additionally, the individual income tax reform in the progressive tax system should also be fully implemented. This is because it could firstly raise the income level of low-income groups, in reduction of their family burden and in improvement their ability of charitable donations. Secondly, through strengthening of individual income tax management policies of high-income groups, issues of tax evasion could be prevented, with tax burdens also potentially able to be raised – this in encouragement of the use of the income tax discounts to make charitable donations. Lastly, as part of reforms, a greater promotion of tax law and a greater use of tax deductions and tax guidance of charitable donations could also be encouraged, to allow more taxpayers to understand the tax deduction system for charitable donations and to incentivise them to donate.

Comments from the Consulting Editor: Reflections on the Basic Experience of China's Tax System Reform in the Past 40 Years

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Abstract: 2018 is the 40th year of Tax Reform after the implementation of “reform and opening up” policy in China, the 40-year Tax Reform has achieved remarkable achievements and attracted worldwide attention. This article reviews the development of tax reform in the past 40 years and believes that the perfection of tax system in the economic field is basically completed. The improvement of tax system in the personal distribution field will become the key point. The adjustment of tax system structure will be included in the vision of “Comprehensively deepening tax reform”. The optimization of tax system will be fully launched. This article summarizes the main experience of tax reform and believes that the 40-year Tax Reform has always adhered to the overall goal of tax reform. The top design and the society’s strong support are the guarantee. They are always closely linked with the economic system reform, always adhere to carry out and improve the tax reform step by step, steadily and gradually, and always adhere to the combination of unified tax law and flexible tax policy. This article puts forward the thinking of further deepening the tax system reform. And believes that deepening the tax system reform should further optimise the tax structure, pay more attention to the overall promotion of comprehensive reforms, strive to realise the internationalisation of China's tax system, make full use of modern scientific and technological means, build a fair, simplified and efficient modern tax system.

Keywords: Tax Reform, 40 Years, Remarkable Achievements

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China has implemented the economic policy of “reform and opening up” and carried out the reform of the industrial and commercial tax system for 40 years. China has made great achievements that attracted worldwide attention.¹ Looking back 40 years ago, in 1978, China's national tax revenue was only RMB51.918 Billion², while 40 years later, in 2017, the national tax revenue had reached RMB14.436987 Trillion³, 278 times higher than that in 1978. At the same time, remarkable progress has been made in the construction of the tax system. In the past 40 years, with amid stupendous changes and vicissitudes, China has initially established a modern tax system that basically meets the requirements of the socialist market economy. Reviewing the experience of tax system reform in the past 40 years, it can be roughly divided into three important development periods.⁴

I. Re-establishment of China's Tax System

The first development period is the re-establishment of China's tax system. Since the Third Plenary Session of the Eleventh Central Committee of the Communist Party (CPC Central Committee) of China was held in 1978 and the economic system reform of “reform and opening up” was established, the construction of the new tax system has experienced the process of gradual recovery, gradual improvement and gradual development. The main purpose of the tax system reform in the first stage is to restore and establish the tax system, which has roughly experienced two major change stages.⁵

1.1 Tax Reform from 1978 to 1981

At the beginning of the founding of the People's Republic of China, New China continued some taxes of the old society and established a new tax system. Later, the tax system has been simplified to an insignificant position in fiscal revenue after many tax system reforms, especially under the influence of the “Non-tax Theory” during the “Cultural Revolution”. Only a kind of industrial and commercial tax is levied on state-owned enterprises, only industrial and commercial tax and industrial and commercial income tax are levied on collectively-owned enterprises, and only urban real estate tax, vehicle and vessel licence plate tax and slaughter tax are levied on individuals and foreigners.⁶ Since 1978, China began to prepare and start the tax system reform, China's tax system construction has entered the recovery period and the brewing and starting period of comprehensive tax system reform. After

¹ The industrial and commercial tax system refers to the system of levying tax on domestic economic activities and income, which is administrated by the State Administration of Taxation, excluding import tariff and ship ton tax. This paper is referred to as the tax system for a shorter form.

² 国家统计局,《中国统计年鉴 2017》,National Bureau of statistics, China Statistical Yearbook 2017, Online < <http://www.stats.gov.cn/tjsj/ndsj/2017/indexch.htm> >.

³ 财政部,《2017年全国一般公共预算收入决算》,Ministry of Finance, 2017 National General Public Budget Revenue Final Statement, Online < <http://www.mof.gov.cn/zhengwuxinxi/caizhengshuju> >.

⁴ 王东山,《对税收征管改革的回顾与认识》,Wang D, ‘Review and Understandings from the Tax Collection and Administration Reforms’, (2003) 4 Taxation Research 31-33.

⁵ 刘佐,《1978年以来历次三中全会与税制改革的简要回顾和展望》,Liu Z, ‘Review and Projection on the Prospects of Tax System Reforms from the Third Plenary Sessions of the Chinese Communist Party Since 1978’, (2014) 4 Review of Economic Research 22-39.

⁶ 金鑫、刘志诚、王绍非,《中国税务百科全书》,Jin X, Liu Z & Wang S, Encyclopedia of China Taxation, Economic Management Press, December 1991, 1st edition, page 163.

comprehensive measures to “turn the chaos out of the way”, the national fiscal and taxation departments have made a lot of preparations for the tax system reform in terms of theory, ideology and organisational restoration.

In terms of theory and ideology, the national fiscal and taxation departments have fully implemented the lines, guidelines and policies of the Third Plenary Session of the Eleventh CPC Central Committee of China, emancipated the mind, sought truth from facts, summarised the historical experience and lessons of tax system construction since the founding of New China, and theoretically corrected a series of erroneous ideas that despised tax and distorted the role of tax. The fiscal and taxation departments put forward the guiding ideology of proceeding from China’s national conditions, acting in accordance with economic laws, increasing the proportion of tax revenue in fiscal revenue, giving full play to the economic leverage of tax revenue, and serving the socialist modernisation. At the end of 1978, the fiscal and taxation departments initially proposed the idea and implementation steps of tax system reform, such as levying state-owned enterprise income tax and individual income tax.⁷

In terms of organisation, the tax authorities at all levels abolished in the “Cultural Revolution” were restored, the work responsibilities of the tax authorities were clarified, the team of tax cadres was enriched, and the basic guarantee was provided for the smooth implementation of the tax system reform at that time.

In order to meet the development needs of China’s economic policy of “reform and opening up”, the post “reform and opening up” tax system reform was initiated in 1979, marked by the pilot reform, which requires the state-owned enterprises⁸ to pay taxes instead of handing over profits to the state. From 1980 to 1981, China successively promulgated the *Income Tax Law of the People’s Republic of China on Chinese-Foreign Equity Joint Ventures*, the *Individual Income Tax Law of the People’s Republic of China* and the *Income Tax Law of the People’s Republic of China for Foreign Enterprises*. At the same time, China has made it clear that the state collects industrial and commercial consolidated tax, urban real estate tax and vehicle and vessel licence plate tax on the business activities of Chinese-foreign equity joint ventures, foreign enterprises and foreign citizens. As a result, China’s foreign-related tax system that is generally applicable to the needs of the time has been preliminarily established, and it has been adapted to the needs of China to introduce of foreign investment and foreign-related economic and technological cooperation in the early stage of opening up to the outside world.

1.2 Tax Reform from 1983 to 1991

The 1980s was the development stage in which China’s tax system reform was explored and fully unfolded. In economic theory, a planned socialist commodity

⁷ 张依婷, 《税收与经济发展的关系——基于我国税制改革的分析》, Zhang Y, ‘Relationship Between Taxation and Economic Development: An Exploration Premised on China’s Tax Reforms’, (2018) 16 *Tax Paving* 21.

⁸ State owned enterprise is the traditional name for state-owned enterprises, which is literally translated as state-run enterprises, which is equivalent to the current state-owned enterprises. State owned enterprise refers to the state-owned ownership or control right of its capital.

economy rectified the direction of the tax system reform at the beginning of the transition. On the basis of carrying out a large number of investigations and pilot projects, the Ministry of Finance submitted the *Tentative Plan of the Industrial and Commercial Tax System Reform* to the State Council in August 1981, which was approved by the State Council in September. The *Tentative Plan* clearly points out that industrial and commercial taxation is the main means of organising national fiscal revenue and marked by the two-step “replacement of profit delivery by taxes” of state-owned enterprises⁹, China launched the first comprehensive reform of industrial and commercial tax system since “reform and opening up”. In November 1982, the State Council proposed a three-year tax system reform task, including “replacement of profit delivery by taxes”, and clarified the strategic objectives of tax system reform and development.

Since January 1, 1983, in order to enhance the vitality of enterprises and solve the distribution relationship between the state and enterprises, the State Council decided to pilot the “replacement of profit delivery by taxes” of state-owned enterprises nationwide, replacing the state-owned enterprises’ profit delivery into an enterprise income tax. This is the first time since the founding of the People’s Republic of China to levy income taxes on state-owned enterprises, breaking through the tradition that state-owned enterprises only hand over profits to the state, and breaking the theoretical forbidden zone that the state cannot levy enterprise income tax on state-owned enterprises. The first step of “replacement of profit delivery by taxes” established a legal-based distribution relationship between the state and enterprises, clarified the economic responsibility of enterprises to the state, mobilised the enthusiasm of enterprises, and gave enterprises the pressure and power to improve their management and economic efficiency. However, the single type of taxation, complicated after-tax profit distribution, and the non- standardised distribution methods have caused shortcomings¹⁰. From September 18, 1984, the State Council approved and transmitted the Ministry of Finance’s *Report on the Implementation of the Second-step Reform of Replacing Profit Delivery by Taxes in State-owned Enterprises* and the *Trial Measures for the Second-step Reform of Replacing Profit Delivery by Taxes in State-owned Enterprises*¹¹ and began to implement the second step of “replacement of profit delivery by taxes”. The two-step reform of “replacement of profit delivery by taxes” has laid the foundation for the full implementation of industrial and commercial tax system reform in China.

In May 1984, the *Government Work Report* at the Second Session of the Sixth National People’s Congress put forward the idea of comprehensively carrying out

⁹ "Replacement of profit delivery by taxes" means that most of the profits originally handed over by state-owned enterprises to the state are replaced by income tax. Before the reform of China's economic system, the distribution relationship between the state and state-owned enterprises was mainly reflected in the profits handed over by state-owned enterprises to the state. In January 1979, 15 local state-owned enterprises in Laohekou City (Hubei Province) took the lead in the first step of the reform of profit to tax.

¹⁰ 金鑫、许毅,《新税务大辞海》,Jin X & Xu Y, New Tax Dictionary, Jiuzhou book Publishing Press, January 1995, 1st edition, page 83.

¹¹ 金鑫、刘志诚、王绍非,《中国税务百科全书》,Jin X, Liu Z & Wang S, Encyclopedia of China Taxation, Economic Management Press, December 1991, 1st edition, page 169.

the reform of the industrial and commercial tax system. On September 18, 1984, the seventh meeting of the Sixth National People's Congress¹² adopted a decision to

“authorise the State Council to draft relevant tax regulations in the process of implementing the reform of “replacement of profit delivery by taxes” in state-owned enterprises and the reform of the industrial and commercial tax system, and promulgated them in the form of draft for trial implementation¹³.”

In accordance with the above decision, since 1984, the State Council has successively issued a series of tax administrative regulations on the collection of state-owned enterprise income tax, state-owned enterprise adjustment tax, product tax, VAT, business tax, salt tax and resource tax. Since then, in accordance with the idea of comprehensively reforming the industrial and commercial tax system, the State Council has successively issued the collection of collective enterprise income tax, private enterprise income tax, urban and rural individual industrial and commercial household income tax, individual income adjustment tax, urban maintenance and construction tax, and bonus tax (including state-owned enterprise bonus tax, collective enterprise bonus tax and public institution bonus tax), state-owned enterprise wage adjustment tax, fixed asset investment direction adjustment tax, special consumption tax, real estate tax, vehicle and vessel use tax, urban land use tax, stamp duty, banquet tax and other tax laws and regulations.

From 1984 to the early 1990s, there are 32 types of tax in China's industrial and commercial tax system. A set of relatively complete tax system has been initially formed, the system differentiated domestic and foreign-funded enterprises, had a dual main body with both turnover tax and income tax and coordinated with other tax systems. After the reform, China's tax system can generally meet the requirements of the situation at the beginning and development stage of China's comprehensive economic system reform. The function of taxation has been strengthened, and the tax revenue has increased steadily in an all-round way. In 1990, various types of tax revenue all reached RMB282.186 Billion¹⁴, which was 5.44 times higher than that in 1978. The state's macroeconomic regulation and control capabilities have also been significantly improved. However, the problems exposed are also more obvious. The prominent manifestations are threefold: 1. There are two sets of tax systems for domestic and foreign enterprises, where the tax treatment is divided according to the nature of enterprise ownership. The differential tax treatment has aroused strong social response; 2. Massive and disorderly types of taxes, as well as a large amount of tax rate levels on product tax resulted in a complex and non-standard tax system, affecting normal business activities; 3. Further tax

¹² 全国人民代表大会.《中华人民共和国第六届全国人民代表大会第一次会议文件汇编》,National People's Congress, Compilation of documents of the first session of the Sixth National People's Congress of the people's Republic of China, 1983.

¹³ 金鑫、刘志诚、王绍非,《中国税务百科全书》,Jin X, Liu Z & Wang S, Encyclopedia of China Taxation, Economic Management Press, December 1991, 1st edition, page 170.

¹⁴ 中华人民共和国国家统计局,《中国统计年鉴 2017》, National Bureau of Statistics of China, *China Statistical Yearbook 2017*, 7-4.

system reform deepening and tax system improvement were required due to the low level of tax compliance and serious tax revenue loss caused by various reasons.¹⁵

II. Deepening the Reform of China's Industrial and Commercial Tax System

The second development period is the deepening reform of China's tax system. In 1992, the Fourteenth National Congress of the Communist Party of China proposed the strategic goal of establishing a socialist market economic system to the whole country¹⁶. The new strategic goal marked that China's economic "reform and opening up" had entered a new historical development stage, and the tax system reform had also entered another golden age.

In 1980 and 1981, China successively promulgated the *Income Tax Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures*¹⁷ and the *Income Tax Law of the People's Republic of China for Foreign Enterprises*¹⁸. After 10 years of practice, on the one hand, the disadvantages of "coexistence of two taxes" for foreign-related enterprises had become increasingly obvious, which is not conducive to China's economic policy of further opening up; on the other hand, the accumulated practical experience was also relatively rich, and the conditions for the realization of the "merger of two taxes" are ripe. In 1991, after the deliberation and approval at the Fourth Session of the Seventh National People's Congress, the *Income Tax Law of the People's Republic of China on Foreign-invested Enterprises and Foreign Enterprises* was promulgated, which took the lead in realising the "merger of two taxes" of foreign-related enterprise income tax and played a prelude to China's comprehensive deepening of tax system reform.¹⁹

Since the Fourteenth National Congress of the Communist Party of China was held in 1992, the national fiscal and taxation departments begun to accelerate the preparations for deepening the tax system reform, drafted the overall plan for comprehensively deepening the industrial and commercial tax system reform and various specific supporting measures for the implementation of the reform. On December 25, 1993, the State Council approved and transmitted the *Application Program for Industrial and Commercial Tax System Reform of the State Administration of Taxation*²⁰, and officially launched a new round of tax system reform. In accordance with the requirements put forward by the Fourteenth National

¹⁵ 李大明,《我国税收征管模式改革的回顾与评析》, Li D, 'Review and Analysis on China's Reform of its Tax Collection and Management Model', (2001) 10 *International Taxation in China* 52-55.

¹⁶ 中国共产党全国代表大会,《中国共产党第十四次全国代表大会文件汇编》 National Congress of the Communist Party of China, *Compilation of documents of the 14th National Congress of the Communist Party of China* 1992.

¹⁷ 《中华人民共和国中外合资经营企业所得税法》 *Income Tax Law of the People's Republic of China Concerning Chinese-Foreign Equity Joint Ventures* 1983 (National People's Congress)

¹⁸ 《中华人民共和国外国企业所得税法》 *Income Tax Law of the People's Republic of China for Foreign Enterprises* 1981 (Standing Committee of the National People's Congress)

¹⁹ 《中华人民共和国外商投资企业和外国企业所得税法与实施细则》 *Income Tax Law and Implementation Rules of the People's Republic of China for Foreign Invested Enterprises and Foreign Enterprises* 1991 (National People's Congress)

²⁰ 国家税务总局税制改革与法规司,《中国工商税制改革》, Department of Tax Reform and Regulations, State Administration of Taxation, *Reform of China's industrial and commercial taxation system* 1994

Congress of the Communist Party of China, and in response to the problems of the tax system, the implementation plan for deepening the tax system reform clearly proposed that

“unify the tax law, fair tax burden, simplify the tax system, reasonably decentralize power, straighten out the distribution relationship, ensure fiscal revenue, and establish a tax system that meets the requirements of the socialist market economy”

are the guiding ideology for comprehensively deepening the tax system reform. At the end of 1993, the State Council successively promulgated new tax regulations, which stipulated that the new tax system would be implemented on January 1, 1994, marking the beginning of a large-scale comprehensive deepening tax system reform in China.

The comprehensive deepening of tax system reform in 1994 is not only an important turning point in China’s tax work, but also an important milestone in the construction of tax system since the founding of New China. In 1994, according to the deployment of the CPC Central Committee and the State Council, and the requirements of establishing and developing the socialist market economic system, China carried out a comprehensive and profound structural reform of the original tax system. At the same time, two sets of tax agencies, the state taxation bureau, and the local taxation bureau, were established throughout the country, each with its own responsibilities and collecting its own taxes. This reform has made major breakthroughs in many issues, both in terms of scope and depth, and laid the foundation of China’s modern tax system. Practice has proved that the comprehensive deepening of tax system reform has had a positive and far-reaching impact on China’s economic system reform and national economic development.²¹²²

The turnover tax was the main source of tax at that time. The key to the tax system reform in 1994 was to comprehensively reform the turnover tax system. In accordance with the requirements of the distribution of fair tax burden in the market economy, and with reference to the generally accepted international turnover tax reform practices, China’s tax system reform in 1994 completely abolished product tax and consolidated industrial and commercial tax, generally levied production-oriented VAT and business tax, supplemented by selective consumption tax. The agricultural and sideline products originally subject to product tax were transformed into agricultural specialty tax. The new turnover tax system treats domestic and foreign-funded enterprises equally and is universally applicable to those enterprises, realising the unification of domestic and foreign-funded enterprises in the turnover tax system.²³

²¹ 韩青, 《我国税收征管模式改革的思路》, Han Q, ‘Thoughts Underlying the Reforms of China’s Tax Collection and Management Model’, (2013) 9 *Taxation Research* 76-78.

²² 梁文永, 常菁, 《我国证券交易税法的立法构想》. Liang W, Chang Q, ‘Legislative Concept of China’s Securities Transaction Tax Law’ (2008) *Mall Modernization*.

²³ 李绍荣, 耿莹, 《中国的税收结构、经济增长与收入分配》, Li S & Geng Y, ‘The Effects of Tax Revenue Structure on Economic Growth and Income Distribution’, (2005) 5 *Economic Research Journal* 118-126.

The tax system reform in 1991 realised the unification of income tax of foreign-funded enterprises. The tax system reform in 1994 not only realised the merger and unification of income tax of all domestic enterprises, more importantly, also achieved the universal application of unified individual income tax to domestic and foreign tax residents. In addition, the 1994 tax system reform also carried out important reforms on special purpose taxes and local taxes. For example, the new land VAT has been established, the resource tax has been optimised, some taxes such as bonus tax and market trading tax have been abolished, the management power of slaughter tax and banquet tax was delegated for the first time, and a new securities transaction tax and inheritance tax were also planned.²⁴

Looking back at the industrial and commercial tax system reform in 1994, China's tax system structure has achieved a major adjustment, and the industrial and commercial tax system has been abolished and converted from 32 tax categories to 18 tax categories. This tax reform has made China's tax system more scientific, standardised, simplified, and efficient, and laid a solid foundation for the establishment of a tax system with Chinese characteristics that meets the requirements of China's socialist market economy.

The tax system reform in 1994 is the largest, widest, richest and most far-reaching tax system reform since the founding of the People's Republic of China. The plan for this tax system reform was based on summing up the tax reform experience and lessons of the "reform and opening up" for more than ten years. After years of accumulation of theoretical research and practical exploration, the plan drew on the successful experience of international taxation practices and other countries' tax system reforms and was formulated in accordance with China's national conditions. Due to full preparations, mature plans, unity of one mind, and social support, the new tax system has been successful and widely praised domestically and worldwide. After the tax system reform in 1994 and subsequent improvements, it was argued that China has established a tax system that initially meets the requirements of Chinese socialist market economic system. The new tax system can play an important role in ensuring national fiscal revenue, strengthening economic macro-control, deepening economic system reform, expanding opening to the outside world, and promoting national economic and social development.

Looking back on the tax system reform in 1994, the success was mainly reflected in six aspects: firstly, after the tax system reform, the national economy continued to maintain high-speed, sustained and good development, and there was no social and economic shock; secondly, it has maintained a substantial increase in tax revenue and standardised the tax distribution relationship between the state and enterprises; thirdly, the growth of tax revenue has been gradually concentrated to the central government, which has enhanced the central government's ability to macro-control the national economy and mobilised the local enthusiasm for economic development; fourthly, with the reform of the tax system, a standardised tax sharing system with Chinese characteristics was established successfully, so that the distribution

²⁴ 梁强, 贾康, 《1994年税制改革回顾与思考:从产业政策、结构优化调整角度看“营改增”的必要性》, Liang Q & Jia K, 'Review and Analysis of 1994 Tax Reforms: A Perspective Showcasing its Necessity in terms of Industry Policy and Structural Optimising Adjustments', (2013) 9 *Public Finance Research* 37-48.

relationship between the central and local governments can move forward in a scientific, legal, standardised and fixed direction. fifthly, the new tax system has taken a big step forward to be scientific, standardised, simplified, fair and efficient²⁵. At the same time, it is closer to being in line with international practice, and the function of taxation has been brought into play; sixthly, the new tax system blocked the loopholes in the tax law, prompted the tax authorities to use modern scientific and technological means to strengthen tax management, improve taxpayers' compliance, improve the ability of tax collection and management, combat tax evasion, and form a social deterrent. However, there are still some unsolved problems in the tax system reform in 1994, which become increasingly obvious with the passage of time. The productive VAT is not conducive to enterprise investment. The coexistence of VAT and business tax produces contradictions and confusion. The tax treatment of domestic and foreign-funded enterprises is different, the reform of local tax system lags behind, and the tax burden of farmers is too heavy. With the development of Chinese reforms, the unfair burden of individual income tax has become increasingly prominent. The emergence of the above problems has restricted the development of China's national economy and the realisation of social justice. Only by further deepening the tax system reform can it be solved fundamentally.

III. Optimisation and Reform of Tax System in the New Century

The third development period is the optimisation and reform of the tax system in the new century and the gradual construction of a modern tax system. The current tax system reform is a tax system improvement based on the tax system reform in 1994.

3.1 Major breakthroughs in tax system reform in the first 10 years of the new century

Marked by the decision of the Third Plenary Session of the Sixteenth CPC Central Committee in October 2003²⁶, the general guiding ideology is to steadily promote tax reform in accordance with the principles of simplifying tax system, broadening tax base, reducing tax rate and increasing control over tax administration and collection. The goal of deepening the tax system reform is to establish a tax system that can adapt to economic fluctuations, effectively adjust and reflect the national industrial policy, promote the sustained, rapid and healthy development of the national economy and meet the normal needs of the state's recurrent budget, the system is required to be aligned with the requirements of the establishment of a socialist market economic system, based on the tax system structure with equal emphasis on the two main bodies of turnover tax and income tax and the auxiliary cooperation of other taxes.

In 2000, the reform of the rural tax and fee system was proposed, and pilot projects were started. Starting from July 1, 2004, eight industries in Northeast China took the

²⁵ 梁强, 贾康, 《1994年税制改革回顾与思考:从产业政策、结构优化调整角度看“营改增”的必要性》, Liang Q & Jia K, 'Review and Analysis of 1994 Tax Reforms: A Perspective Showcasing its Necessity in terms of Industry Policy and Structural Optimising Adjustments', (2013) 9 *Public Finance Research* 37-48.

²⁶ 《中国共产党十八届三中全会公报》 Communiqué of the Third Plenary Session of the 18th Communist Party of China, *China's cooperative economy* 2013(11): 5-7.

lead in piloting the conversion of VAT from production-oriented to consumption-oriented, and the input tax contained in machinery and equipment can be deducted. In March 2005, the Fourth Session of the Tenth National People's Congress approved the *Outline of the Eleventh Five-Year Plan*, which proposed 10 tax reforms: 1. Realise the nationwide transformation from production-oriented VAT to consumption-oriented VAT 2. Appropriately adjust the scope of consumption tax collection, and rationally adjust the tax burden level and collection methods of certain taxable items; 3. Levy fuel tax when necessary; 4. Reasonably adjust the scope and taxable items of business tax; 5. Improve the export tax rebate system; 6. Unify the tax system of different types of enterprises; 7. Implement a comprehensive tax system which combines global and schedular individual income tax systems; 8. Reform the real estate tax system, with steady implementation of the property tax and gradual cancellation of relevant charges; 9. Reform the resource tax system; 10. Improve the urban maintenance construction tax system, farmland occupation tax system, and stamp duty system²⁷.

The deepening of the tax system reform in the new century shoulders the important task of connecting the past and the future. The reform has achieved major historic breakthroughs in four aspects. Firstly, the agricultural-related taxes such as agricultural tax, animal husbandry tax and slaughter tax were completely abolished in 2006, which directly reduced the burden on farmers and realised a major transformation of industry supporting agriculture. Secondly, with the implementation of the new corporate income tax legislation in 2008 as a sign, the taxation of domestic and foreign-funded enterprises has been completely unified, the 30-year history of establishing tax systems according to enterprises' nature has ended, the long-term tax differential treatments have been eliminated, and the principle of tax fairness has been realised. Since then, domestic and foreign-funded enterprises can be treated equally within the tax system and compete fairly. Thirdly, since 2009, the national VAT has changed from production-oriented to consumption-oriented. The input VAT contained in the purchase of machinery and equipment can be offset against the output tax, which has effectively promoted the equipment renewal and technological transformation of product manufacturers and enhanced the strength of enterprises to participate in international competition. The reform of VAT has achieved a new breakthrough. Finally, since 2009, the tax reform of refined oil has been implemented, the consumption tax has been imposed on refined oil, six related charges have been removed, the tax system has been optimized, and a breakthrough in changing fees to taxes has been achieved. Nevertheless, there are still some tax reform tasks that have not been completed, and the tax system reform needs to be further deepened²⁸.

²⁷ 中华人民共和国国民经济和社会发展第十一个五年规划纲要》. Twelfth Five-year Plan of Economic and Social Development of the People's Republic of China, *Communiqué of the Standing Committee of the National People's Congress of the People's Republic of China* 2006(03):18-61.

²⁸ 王军, 《深化税制改革 服务发展大局》, Wang J, 'Deepening of Tax Reform to Serve the Overall Development Scenario', (2013) 24 *Qiushi* 28-30.

3.2 The Task of Optimising Tax System Reform in the Past 10 Years of the New Century

On the basis of the tax system reform in the first 10 years of the new century, the *Outline of the Twelfth Five-Year Plan for the National Economic and Social Development* approved by the Fourth Session of the Eleventh National People's Congress in March 2011 proposed to improve the budget and tax systems, and actively build a fiscal and tax system that is conducive to transforming the economic development mode. In accordance with the principles of optimising the tax system structure, fair tax burden, standardising distribution relations, and improving the allocation of tax rights, the tax system should be improved, and the construction of the legal tax system should be strengthened²⁹.

Based on the above ideas, there are eight basic tasks for tax reform during the "Twelfth Five-Year Plan" period: 1. Expand the collection scope of VAT and reduce business tax and other taxes accordingly. 2. Reasonably adjust the collection scope, tax rate structure and taxable level of consumption tax. 3. Gradually establish and improve the combination of global and schedular individual income tax system and promote the individual income tax administration mechanism. 4. Continue to promote the fee-to-tax conversion reform, and comprehensively promote the reform of resource tax and farmland occupation tax. 5. Study and promote the reform of real estate tax. 6. Gradually improve the local tax system and grant the provincial government appropriate tax administration authority. 7. Improve the price formation mechanism of resource products. According to the linkage mechanism of price, tax, fee, and rent, appropriately increase the resource tax burden, improve the calculation method, and change the tax collection method of important resource products from quantity and quota to ad valorem rate, so as to promote the rational development and utilisation of resources. 8. Promote the reform of the environmental protection fee system, actively promote the reform of environmental taxes and fees, levy environmental protection taxes on items with heavy prevention and control tasks and mature technical standards, and gradually expand the scope of collection. A modern taxation system that is unified, standardised, and scientific, and conforms to international practices and the requirements of the socialist market economy system, has been initially established. This is the first time that the goal of establishing a modern tax system has been put forward since the "reform and opening up".

The *Decision of the Third Plenary Session of the Eighteenth CPC Central Committee*³⁰ in 2013 pointed out that finance is the foundation and important pillar of national governance, and a scientific fiscal and taxation system is the institutional guarantee for optimising resource allocation, maintaining market unity, promoting social equity and achieving long-term stability of the country. The authorities must improve legislation, clarify powers, reform the tax system, stabilise the tax burden, and give full play to the enthusiasm of the central and local governments. It is necessary to improve the budget management system, perfect the tax system, and

²⁹ Above note 28.

³⁰ 《中共中央关于全面深化改革若干重大问题的决定》*Decision of the Central Committee of the Communist Party of China on Several Major Issues on Comprehensively Deepening Reforms* 2013 (Central Committee of the Communist Party of China)

establish a system in which the government's administrative authority is commensurate with its spending responsibility. The decision clearly pointed out the direction of deepening the tax system reform: 1. Deepen the reform of the tax system, improve the local tax system, and gradually increase the proportion of direct tax. 2. Promote the reform of VAT and appropriately simplify the tax rate. 3. Adjust the collection scope, taxable level and tax rate of the consumption tax, and capture the high energy consumption, high pollution products and some high-end consumer goods into the collection scope of consumption tax. 4. Gradually establish a comprehensive global and schedular individual income tax system 5. Accelerate the legislation of real estate tax and timely promote the reform, accelerate the reform of resource tax, and promote the conversion of environmental protection fees into taxes. 6. In accordance with the principles of a unified tax system, fair tax burden and promotion of fair competition, strengthen the standardised management of tax incentives, especially regional tax preferential policies. Preferential tax policies must be uniformly stipulated by special tax laws and regulations. 7. Improve the national and local tax collection and administration systems. The Third Plenary Session of the Eighteenth CPC Central Committee carried forward the past and forge ahead into the future and planned the general goal of future tax reform from a strategically advantageous position.

In order to implement the resolution of the Third Plenary Session of the Eighteenth CPC Central Committee, the third meeting of the Central Leading Group for Comprehensively Deepening Reform considered and adopted the *Overall Plan for Deepening the Reform of the Fiscal and Tax System* on June 6, 2014. On June 30, 2014, the Political Bureau of the CPC Central Committee convened a meeting. Xi Jinping, General Secretary of the CPC Central Committee, chaired the meeting and reviewed and approved the *Overall Plan for Deepening the Reform of the Fiscal and Taxation System*³¹. The plan pointed out some aspects, including to deepen the reform of the tax system, optimise the tax system structure, improve the tax function, stabilise the macro tax burden, promote the administration of tax according to law, establish a tax system that is conducive to scientific development, social fairness and market uniformity, and give full play to the function of tax in raising fiscal revenue, adjusting distribution and promoting structural optimisation. According to the *Plan*, the new round of fiscal and tax system reform will basically complete the key work and tasks in 2016, and a modern fiscal system will be established in 2020.

In March 2016, the *Outline of the Thirteenth Five-Year Plan for the National Economic and Social Development of the People's Republic of China*³² adopted at the Fourth Session of the Twelfth National People's Congress further defined the reform objectives, in which Chapter 15 specifically discussed accelerating the

³¹ 财政部,《中共中央政治局召开会议审议<深化财税体制改革总体方案>等》, Ministry of Finance, 'The Political Bureau of the Central Committee of the Communist Party of China held a meeting to consider the General Plan for Deepening the Reform of the Financial and Taxation System, etc.' *Transport Finance and Accounting* (2014)07:96-96.

³² 全国人大财政经济委员会,《2016-2020<中华人民共和国国民经济和社会发展第十三个五年规划纲要>解释材料》 Committee on Finance and Economy of the National People's Congress, 'Explanatory Materials for the 13th Five-Year Plan for National Economic and Social Development of the People's Republic of China, 2016-2020', China Planning Press (2016).

reform of the fiscal and tax system³³. 1. China will deepen reforms to create sound and modern fiscal and tax systems, focusing on key issues including delineating the powers and spending obligations of the central and local governments, improving local taxation systems, strengthening local development capacity, and reducing burdens on enterprises. 2. Given the need to optimise the tax system, keep the tax incidence stable at the macro level, and ensure taxes are administered in accordance with the law, China must fully implement the principle of law-based taxation; establish a modern tax system which is composed of well-conceived tax categories, is better structured, legally sound, well-regulated, and fair, and which allows for efficient administration; and gradually increase the proportion of direct tax. 3. China will complete across the board the reform to replace business tax with VAT and establish a standardised consumption-based VAT system. 4. China will improve the consumption tax system. 5. China will impose ad valorem tax on resources and steadily extend the scope of resources covered by the tax. 6. China will introduce an environmental protection tax. 7. China will improve local tax systems and move forward with legislation to introduce a real estate tax.

The full realisation of the task of tax system reform proposed in the Third Plenary Session of the Eighteenth CPC Central Committee and the *Outline of the Thirteenth Five-Year Plan* will be the basic completion of the establishment and improvement of China's modern tax system.

3.3 Achievements in Optimising Tax System Reform in the Past 10 Years of the New Century

Marked by the first implementation of replacing business tax with VAT (“Replacing Business Tax with Value-added Tax”) in Shanghai in 2012, China implemented the strategic deployment of the national supply side reform, steadily promoted the “Replacing Business Tax with Value-added Tax” reform. Until May 1, 2016, China has comprehensively completed the reform of replacing business tax with VAT nationwide and established a basically standardised consumption-based VAT tax system. After pilot projects, the reform of ad valorem calculation of resource tax began on July 1, 2016, and the scope of taxation was gradually expanded. After more than ten years of research, on December 25, 2016, the 25th Meeting of the Standing Committee of the Twelfth National People's Congress passed the *Environmental Protection Law*, which will be implemented on January 1, 2018. In addition, on December 27, 2017, the 31st Meeting of the Standing Committee of the Twelfth National People's Congress passed the *Tobacco Tax Law* and the *Ship Ton Tax Law*, which will come into force on July 1, 2018³⁴. In June 2018, the National People's Congress announced the revision of the *Individual Income Tax Draft*, taking an important step towards the gradual establishment of a comprehensive global and

³³ 徐绍史,《全国人民代表大会财政经济委员会关于<中华人民共和国国民经济和社会发展第十三个五年规划纲要>实施中期评估的调研报告》, Xu S, ‘Research Report of the Committee on Finance and Economy of the National People's Congress on the Mid-term Evaluation of the Implementation of the 13th Five-Year Plan for National Economic and Social Development of the People's Republic of China’, *Communiqué of the Standing Committee of the National People's Congress of the People's Republic of China* (2019)01:257-263.

³⁴ 肖捷,《关于<中华人民共和国烟叶税法(草案)>的说明》, Xiao J, ‘Notes on the (Draft) Law of the People's Republic of China on Tobacco Tax’, *Communiqué of the Standing Committee of the National People's Congress of the People's Republic of China* (2018), 000(001):22-22.

schedular individual income tax system. So far, among the current 18 tax categories in China, six taxes, including individual income tax, corporate income tax, vehicle and vessel tax, environmental protection tax, tobacco tax and ship ton tax have been levied by the legislative provisions of the National People's Congress. The main framework of China's modern tax system has been basically established, and the modern tax system is taking shape.

After nearly 10 years of optimised tax reform in the new century, the improvement of the tax system in the economic field will be basically completed marked by the full implementation of the "replacing business tax with value-added tax"; The improvement of the tax system in the field of individual distribution will be marked by the deepening of the reform of individual income tax and real estate tax; Marked by improving the local tax system and gradually increasing the proportion of direct taxes, the adjustment of the tax system structure will be included in the vision of comprehensively deepening the tax system reform; The optimisation of the tax system will be fully launched with the adjustment of consumption tax and the environmental protection fee to tax conversion reform.

IV. Reflections on the Basic Experience of China's Tax System Reform

One of the important signs of the success of China's tax system reform is to ensure the sustained and stable growth of tax revenue. In 1978, the national tax revenue was only more than RMB50 Billion, while in 2017, the tax revenue has reached more than RMB14 Trillion. While deepening the reform of the tax system, tax revenue has achieved high growth for 40 consecutive years, which have created a miracle in the worldwide tax history. It is very important to summarise the experience of tax system reform in the past 40 years.

4.1 Basic experience of the tax system reform for 40 years

The experience of 40 years of tax system reform tells us that China's tax system reform has always adhered to one goal, that is, the transformation from planned economy to socialist market economy system. The tax system reform should meet the requirements of perfecting the socialist market economic system.

1. Always adhere to the overall goal of one tax system reform and unswervingly is the direction. The goal of establishing a tax system with unified tax administration, fair tax burden, promoting competition, tax legal system and is conducive to openness. The ultimate goal of developing the socialist market economy in China is to develop the productive forces, liberate the productive forces and realise the aspirations of the broad masses of the people for a better life. In order to establish a socialist market economy, China must eliminate regional blockades, separate market regimes and establish a unified national market to liberate the productive forces³⁵.

³⁵ 韩绍初. 《在改革中不断前进的中国税收——对改革开放三十年税制改革历程的回顾》 Han S. 'China's Taxation in the Midst of Reform - A Review of the Thirty Years of Reform and Opening Up of the Tax System', *Foreign Taxation* (2008)09:8-13+1.

Therefore, the tax law must be unified and complete. The Eighteenth CPC National Congress proposed that “both initial distribution and redistribution should take into account efficiency and fairness, with particular emphasis on fairness in redistribution”. To regulate social distribution, the tax burden fairness must be realised, which is also the objective requirement of socialist market economy. The essence of market economy is competitive economy. Only when enterprises fully compete can the market be full of vitality and vitality. China’s tax system reform is to promote enterprise competition. The market economy requires the rule of law in taxation. China's tax system reform has always adhered to the rule of law. The market economy requires an open tax system, where China’s tax system reform has followed the international taxation practice and has initially established a modern tax system in line with international standards.

2. The top-level design of the top leadership and the strong support of all sectors of society are the guarantee. Reviewing the 40-year history of China’s tax system reform, each major tax system reform has been highly valued by the Party Central Committee and the State Council and incorporated into national-level strategic decisions. Each major tax reform has been fully prepared and publicised, and social opinions have been extensively solicited. Especially since the new century, the transparency of tax legislation has been continuously enhanced. Soliciting public opinions and absorbing the participation of the whole society can get strong support from all sectors of society.

3. The tax system reform has always been closely linked with the economic system reform. Reviewing the 40-year history of China’s tax system reform, each major tax system reform period is also a period of strategic adjustment for China’s deepening economic system reform. The tax system reform has always been subject to and served the strategic needs of the overall situation of China’s “reform and opening up”, subject to and serve the strategic needs of macroeconomic development, cooperate with and promote the needs of various reforms and development in the process of establishing a socialist market economy³⁶.

4. Always adhere to the strategic idea of gradual and steady implementation and gradual improvement of tax system reform³⁷. Under the guidance of long-term goals and planning, every tax reform in China adheres to the gradual reform to avoid the so-called “shock therapy” and the fierce social unrest. The VAT reform has been piloted since 1979 and realised the “replacing business tax with value-added tax” in 2016. After 40 years, it is still being improved. Since 1980, the reform of enterprise income tax has gone through 30 years. The reform firstly unified the income tax of

³⁶ 杨之刚, 《深化税制改革 适应经济社会发展》, Yang Z, ‘Deepening of Tax Reforms to Adapt to Economic and Social Development’, (1999) 12 *Finance & Trade Economics* 14-19.

³⁷ 程瑜, 《深化我国税制改革的路径选择》, Cheng Y, ‘Path Selection for the Deepening of China’s Tax Reforms’, (2010) 10 *Taxation Research* 33-37..

foreign-funded enterprises, then unified the income tax of domestic funded enterprises, and finally realised the unification of income tax of domestic and foreign-funded enterprises in 2008. The steady implementation of tax reform has been widely recognised and praised by the international community.

5. Always adhere to the combination of unified tax law and flexible tax policy. Looking back on the 40-year history of China's tax system reform, each major tax system reform is faced with the overall and partial re-adjustment of the distribution relationship. Therefore, various contradictions and conflicts are inevitable. In the face of the overall situation of tax system reform and the choice of resolving conflicts, China's tax system reform has adopted pilot projects and then promoted the projects, and the establishment of new systems combined with flexible transitional policies has better resolved the contradictions and conflicts in the implementation of tax system reforms³⁸.

Although China's tax system reform has made progress and success, there is no doubt that the reform is still on the way, and the current tax system is still far from reaching the ultimate goal of fairness, legal system, scientific, standardisation, simplification, and efficiency. Generally speaking, China's tax system is still mainly based on taxation of physical products and services. In 2017, tax goods and service-related tax revenues were RMB82573.94 Trillion, accounting for about 57.2% of overall tax revenue. Taxes are mainly levied on the national economy. The tax revenue in the economic sector is about RMB127493.08 Trillion, accounting for about 88.31% of overall tax revenue³⁹. This situation shows that China's tax system is not a socialised tax system under the general market economy, and there is still a big gap between the requirements of establishing a modern tax system.

4.2 Thoughts on deepening the reform of tax system

On October 25, 2017, Xi Jinping, who was re-elected as General Secretary of the CPC Central Committee, once again made clear with Chinese and foreign reporters that China's "reform and opening up" will continue to advance. President Xi said that China will continue to promote the modernisation of the national governance system and governance capabilities, unswervingly deepen reforms in all aspects, and unswervingly expand opening up, so that "reform and opening up" will promote and complement each other. With the development of the openness of China's socialist market economy, the risks of China's market economy will increase, and the tax risk will inevitably further increase. The objective need to establish a modern tax system is becoming increasingly urgent⁴⁰.

³⁸ 曹文, 曾耀辉, 《深化财税体制改革的几点思考》, Cao W & Zeng Y, 'Several Thoughts on Deepening Finance and Tax System Reforms', (2016) 11 *Taxation Research* 101-104.

³⁹ Above note 4.

⁴⁰ 央视网, 《新当选的中共中央总书记习近平和中央政治局常委同中外记者见面》, Xinhua Press, 'Newly elected General Secretary of the CPC Central Committee Xi Jinping and the Standing Committee of the Central Political Bureau meet with Chinese and foreign journalists', *Xinhua Net*, 25 October 2011 <<http://tv.cctv.com/2017/10/25/VIDEA306bjW8c08Q32b7I0a171025.shtml>>

Marked by the four major tax system reforms (abolition of the agricultural tax system, merger of domestic and foreign enterprise income tax, the transformation of VAT and the reform of “replacing business tax with value-added tax”), China’s reform of the framework of taxation entities in the economic field has been basically completed. China’s tax system reform is facing new opportunities and challenges. In order to resist tax risks and improve China’s modern tax system under the socialist market economic system, it is necessary to start a comprehensive reform of tax structure adjustment and taxation in the economic and social fields as soon as possible. The practice of tax system reform all over the world has proved that tax system must be continuously reformed and improved in accordance with the rules of the market economy.

1. In the reform of the tax system, the structure of the tax system should be further optimised. The *Decision* of the Third Plenary Session of the Eighteenth CPC Central Committee of China proposed to gradually increase the proportion of direct taxes. The *Outline of the Thirteenth Five-Year Plan* also emphasized the establishment of a modern tax system with scientific tax types, structural optimisation, sound laws, standardization, fairness and efficient collection and administration, and gradually increased the proportion of direct taxes. Looking at the current tax situation in the world, statistical studies have shown that since 1965, developed market economies have had a basically stable tax structure, with income tax, goods and services tax, and social security tax. The task of further optimising the tax system structure in China is still onerous⁴¹. In deepening the reform of the tax system, it is necessary to maintain the overall structure of the dual main body of income tax and goods and services tax unchanged, gradually increase the proportion of direct taxes, and gradually increase the proportion of taxes levied on society.

2. In the tax system reform, China should pay more attention to the overall promotion and comprehensive reform. Looking back on the 40-year history of China’s tax system reform, especially the tax system reform in recent 20 years, the publicity of single tax reform and tax reduction reform is more prominent, forming the misunderstanding that reform is tax reduction. The *Outline of the Thirteenth Five-Year Plan* calls for stabilising the macro tax burden. Future tax system reform can only make structural adjustment. More attention should be paid to the cooperation between various taxes and comprehensive reforms⁴².

3. In the tax system reform, we should strive to realise the internationalisation of China’s tax system. China has deeply integrated into the international community and become a member of the world economic system. In the context of China’s implementation of the “One Belt, One Road” initiative and major changes in international taxation, in order to support further expansion of “reform and opening up” and encourage Chinese enterprises to “go global”, China’s continued deepening

⁴¹ 解学智, 张志勇, 《世界税制现状与趋势(2014)》, Xie X & Zhang Z, *Global Taxation Systems: Status and Trends*, (China Tax Publishing House, 1st ed, 2014)

⁴² 胡怡建, 《我国税收改革发展的十大趋势性变化》, Hu Y, ‘Ten Trends within China’s Taxation Reform and Development’, (2015) 2 *Taxation Research* 3-9.

of tax reform should pay more attention to comply with international tax rules and lead international tax standards, and realise the internationalisation of China's tax system⁴³⁴⁴.

4. Full use of modern technological means should be used in the reform of the tax system. The advancement of modern technology, on the one hand, has created many new economic industries and economic forms, and left serious challenges to the traditional tax system. On the other hand, it has also provided technical support for tax innovation. As China continues to deepen the reform of the tax system, we should fully consider the current situation and future of the development of informatisation, networking and big data, and the needs of implementing the reconstruction of the tax system structure, organizational structure, and tax collection and administration process⁴⁵⁴⁶.

5. In the tax system reform, a fair, simplified and efficient modern tax system should be further built. Although the tax system reform has gone through 40 years, the development of the tax system has experienced a process from simple to complex, and then from complex to simple. However, the current tax system still has complex and inefficient aspects, as VAT and individual income tax still cannot reach the ideal state. This is determined by the stage and historical limitations of the development of the tax system. The problems that have arisen in the reform can only be solved fundamentally by continuing to deepen the reform.

I believe that with the guidance of the resolutions of the Third Plenary Session of the Eighteenth CPC Central Committee and the outline of the Thirteenth Five-Year Plan, the efforts of tax theorists and practitioners, especially the understanding and support of taxpayers, China's tax reform will definitely be able to achieve the goal of establishing a modern tax system.

⁴³ 孙艳华, 《刍议金融危机背景下财政税收改革》, Sun Y, 'Tax Law Reforms Under the Context of Financial Crises', (2018) 21 *Tax Paying* 17.

⁴⁴ 陆轶琦, 《国际税收竞争现状与我国改革路径探析》, Lu Y, 'Exploration of International Tax Competition and Chinese Reforms', (2018) 19 *Tax Paying* 7, 10..

⁴⁵ 江武峰, 《大数据背景下税收管理改革的实践与思考》, Jiang W, 'Thoughts on the Empirical Implementation of Tax Administration Reforms Under the Big Data Context', (2018) 1 *Taxation Research* 113-116.

⁴⁶ 张金华, 《新形势下财政税收体制改革的创新研究》, Zhang J, 'Analysis of Innovation in Tax Institutional Reforms Under New Circumstances', (2018) 16 *Accounting Learning* 156.

