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Jun Zhao, George Tian, Xi Nan and Ziyuan Bai

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Dongsheng Jin and Yuan Li

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ABOUT THE JOURNAL

The importance of China on the global
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Editorial

The 2022, Vol. 12 Issue 1 of the Journal of Chinese Tax and Policy features articles pertaining to the current nature, characteristics, design, and effectiveness of specific areas of the taxation system: in exploration for further understandings of the status quo, and as a basis for future improvements.

Zhao, Tian, Nan and Bai's *Achievements and Challenges: Addressing the Lack of Certainty in the PRC's Continuing Education Special Additional Deduction Policy – Insights from Australia* analysed the Continuing Education Deduction policy within the Chinese Individual Income Tax Law, pertaining to the policy effectiveness in implementation, and as underlaid by its design. This article explores major challenges for enforcing the tax deduction rules on continuing education and its in-depth reasons. It also contends that Australia's work-related self-education deduction policy could serve as an excellent example of policy certainty and inform China's further reform.

Martini's *A Review of China Approach to Cooperative Compliance in Light of the International Tax Practice and the OECD Framework* seeks to rather ascertain the nature and characteristics of the Chinese cooperative tax compliance system, testing the congruency of existing policies in China against various international norms and cooperative compliance implementations worldwide.

Jin and Li's *Research on China's Current Charity Tax Policy and Directions for Improvement* explored the design and features of charity tax regulations alongside its current role of within the primary to tertiary redistributions, particularly in terms of its implications to differing individuals and collectives. Directions for future reforms are also proposed, grounded on its analyses of current policy, its scope, and its implementation.

Eva Huang

Sydney, October 2022

Achievements and Challenges: Addressing the Lack of Certainty in the PRC's Continuing Education Special Additional Deduction Policy – Insights from Australia

Jun Zhao, George Tian, Xi Nan and Ziyuan Bai^{*}

Abstract: Chinese tax residents receiving comprehensive income¹ are now allowed a deduction when they gained continuing education. This deduction is a result of the most recent amendment of the *Law of the People's Republic of China on Individual Income Tax (Individual Income Tax Law)*² in 2018. The amended *Individual Income Tax Law*³ came into effect on 1st January 2019. According to the new rules, taxpayers pursuing continuing education are eligible for a deduction of RMB 400 per month for a maximum of 48 months for a degree or RMB 3,600 for professional qualification education. However, in practice, such benefits seem not easy to obtain.⁴ This article examines the policy effectiveness of the Continuing Education Deduction according to Adam Smith's four principles of good taxation design: convenience, certainty, economy and equality. It pays particular attention to the compliance certainty of this deduction for taxpayers. It explores major challenges for enforcing the tax deduction rules on continuing education and its in-depth reasons. It contends that Australia's work-related self-education deduction policy could serve as an excellent example of policy certainty and inform China's further reform of the Continuing Education Deduction policy.

Keywords: Individual Income Tax; Special Additional Deduction; Continuing Education Deduction; Policy Effectiveness

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¹ 《中华人民共和国个人所得税法》 *Law of the People's Republic of China on Individual Income Tax* 2018 (Standing Committee of the National People's Congress).

² Ibid.

³ Ibid.

⁴ <http://www.lawsdom.com/newsitem/278245382> ; and Vicky Zhang, 'Everything You Need To Know About China's Individual Income Tax in 2022', (HROne, March 15, 2022) (Note: China Individual Income Tax, China tax, IIT, Individual Income Tax, tax return) at <https://www.hrone.com/blog/china-individual-income-tax/>

I. Introduction

Chinese tax residents receiving comprehensive income⁵ are now allowed a deduction when they gained continuing education. This deduction is a result of the most recent amendment of the *Law of the People's Republic of China on Individual Income Tax (Individual Income Tax Law)*⁶ in 2018. The amended *Individual Income Tax Law*⁷ came into effect on 1st January 2019, allowing tax resident individuals to claim the Special Additional Deductions each fiscal year. In the PRC, a fiscal year starts on 1st January and ends on 31st December of each calendar year.⁸

The specific scope, standards and claiming steps of the Continuing Education Deduction were not included in the *Individual Income Tax Law*.⁹ The *Interim Measures for Special Additional Deductions for Individual Income Tax (Interim Measures)*¹⁰ stipulated the deduction scope and standards, and the *Operating Measures for Special Additional Deduction for Individual Income Tax (Trial) (Operating Measures)*¹¹ stipulated the deduction claiming steps.

According to the new rules, taxpayers pursuing continuing education are eligible for a deduction of RMB per month for a maximum of 48 months for a degree or RMB 3,600 for professional qualification education. However, in practice, such benefits seem not easy to obtain.¹² Although the *Interim Measures*¹³ and *Operating Measures*¹⁴ were promulgated, taxpayers still have questions regarding the Continuing Education Deduction policy. The State Taxation Administration collected two hundred frequently asked questions, of which more than thirty questions were related to the Continuing Education Deduction.¹⁵ These questions were answered and released on the 12366 Tax Service Platform,¹⁶ which presents taxpayers' confusion when claiming the Continuing Education Deduction.

This article examines the policy effectiveness of the Continuing Education Deduction according to Adam Smith's four principles of good taxation design: convenience, certainty, economy and equality. It pays particular attention to the compliance certainty of this deduction for taxpayers. It explores major challenges for enforcing the tax

⁵ Above note 1.

⁶ Above note 1.

⁷ Above note 1.

⁸ Above note 1, Art 1.

⁹ Above note 1.

¹⁰ 《个人所得税专项附加扣除暂行办法》 Interim Measures for Special Additional Deductions for Individual Income Tax 2018 (State Council).

¹¹ 《个人所得税专项附加扣除操作办法(试行)》 Operating Measures for Special Additional Deduction for Individual Income Tax (Trial) 2018 (State Taxation Administration).

¹² <http://www.lawsdom.com/newsitem/278245382>; and Vicky Zhang, 'Everything You Need To Know About China's Individual Income Tax in 2022', (HROne, March 15, 2022) (Note: China Individual Income Tax, China tax, IIT, Individual Income Tax, tax return) at <https://www.hrone.com/blog/china-individual-income-tax/>

¹³ Above note 10.

¹⁴ Above note 11.

¹⁵ 国家税务总局, 《个人所得税专项附加扣除 200 问》, State Taxation Administration, 'Two Hundred Questions for Special Additional Deductions on Individual Income Tax', 19 January 2019, Online, <<https://12366.chinatax.gov.cn/zqdetail/getcontentPage?lmbm=2d05f99896e041c2a06a1d8a&contentId=0f3c5b9ce691422fb7f24859ed501214&logoid=e48cc09d6752e977016755358f0b005d&from=groupmessage>> (23 Aug. 2020).

¹⁶ 国家税务总局 12366 纳税服务平台, '12366 Tax Service Platform of State Taxation Administration' <<https://12366.chinatax.gov.cn>> (12 Nov. 2020).

deduction rules on continuing education and its in-depth reasons. It contends that Australia's work-related self-education deduction policy could serve as an excellent example of policy certainty and may inform China's further reform of the Continuing Education Deduction policy.

II. Existing Studies on China's Continuing Education Deduction policy and their Limits

The *Law of the People's Republic of China on Individual Income Tax (Individual Income Tax Law)*¹⁷ was amended on 31st August 2018.¹⁸ Since the revised law was promulgated, many articles discussed the six Special Additional Deduction policies as a whole, but not many articles specifically discussed the Continuing Education Deduction policy. Research related to the Continuing Education Deduction policy in the People's Republic of China (PRC) can be divided into three categories.

The first category of articles concluded that the Continuing Education Deduction policy could effectively reduce taxpayers' burden without doing empirical experiments, such as Long and Liang's article¹⁹ and Yang and Liu's article.²⁰ These articles summarised the policy that taxpayers who gained continuing education for academic qualification (degree) could claim RMB 4,800 per year and who gained vocational qualification could claim RMB 3,600 per year, which shows that taxpayers have one more option to claim deductions in the PRC. In these articles, researchers provided no connection with the conclusion that the Continuing Education Deduction policy could effectively reduce taxpayers' burden.

The second category of articles mainly criticised the Continuing Education Deduction policy for the lack of detail. Wu, Wang and Song's article²¹ highlighted that taxpayers might gain education for academic qualification (degree) through radio, television, and other long-distance means. It might accept education for vocational qualifications from training, seminar activities and qualification exams. The authors raised concerns about who is a qualified education provider. There is no relevant detail in the *Interim Measures for Special Additional Deductions for Individual Income Tax (Interim Measures)*²² and *Operating Measures for Special Additional Deduction for Individual Income Tax (Trial) (Operating Measures)*,²³ which may lead to problems in practice. Zhang's article²⁴

¹⁷ Above note 1.

¹⁸ *Ibid.*

¹⁹ 龙凤好、梁燕瑜，《浅谈新个人所得税法专项附加扣除》，Long F & Liang Y, 'Discussion on Special Additional Deductions on Individual Income Tax Law', (2019) *Technology and Economic Guide* 27, at 181-182.

²⁰ 杨广莉、刘颖婷，《个税专项附加扣除及税务处理研究—基于比较分析法》，Yang G & Liu Y, 'Study on Special Additional Deduction on Individual Income Tax Law and Relevant Tax Treatment - Based on Comparative Analysis', (2019) *Friends of Accounting* 19, at 134-138.

²¹ 吴旭东、王晓佳、宋文，《个人所得税专项附加扣除研究》，Wu X, Wang X & Song W, 'Research on Special Additional Deduction within Individual Income Tax Law', (2019) *Research on Financial and Economic Issues* 02, at 79-86.

²² 《个人所得税专项附加扣除暂行办法》 Interim Measures for Special Additional Deductions for Individual Income Tax 2018 (State Council).

²³ 《个人所得税专项附加扣除操作办法(试行)》 Operating Measures for Special Additional Deduction for Individual Income Tax (Trial) 2018 (State Taxation Administration).

²⁴ 张凯迪，《个人所得税教育专项扣除的国际经验借鉴与比较》，Zhang K, 'The Reference and Comparison of The International Experience of the Special Additional Deduction on Individual Income Tax Law', (2018) *Fiscal Science* 12, at 147-153.

stated that the policy is too simple, especially the deduction standard. Taxpayers can only apply a fixed amount deduction according to different types of continuing education, not according to the actual expenses incurred. Zhang highlighted that the specified amount deduction could not reflect the costs incurred by taxpayers, especially those who incurred more continuing education expenditures.²⁵ Zhang's article also pointed out that the provision might negatively impact the policy's income redistribution and education promotion functions.²⁶

The third category of articles compared the Continuing Education Deduction policy with similar policies in other jurisdictions. Wu and Zheng's article²⁷ described similar policies in Hong Kong, Germany, Australia, and the Netherlands. They highlighted that these jurisdictions have different limitations on their policies.²⁸ For example, in Hong Kong, taxpayers are entitled to claim a deduction when they gain continuing education relating to any employment. In Australia, taxpayers are entitled to claim an education deduction for "work-related" purposes.²⁹ Zhang's article³⁰ described similar policies in the United States, France, Canada, Germany and Australia. Zhang summarised the deduction scope and suggested including more details in the Continuing Education Deduction policy. Li and Cai's article³¹ outlined similar policies in the United States, the Netherlands, Denmark, Korea, Brazil, India and Malaysia. They discussed the tax reduction methods adopted by these countries, such as pre-tax deduction, tax credit, education savings plans and financial subsidies.³²

Table 2-1 summarised the policy comparison from Wu and Zheng's article³³, Zhang's Article³⁴ and Li and Cai's article³⁵.

Table 2-1 Summary of the Policies in Six Jurisdictions

Jurisdiction	Summary of the Policies
Australia	<p>Deduction prerequisite: (1) the education is conducive to obtaining a formal employment qualification; (2) the curriculum must be related to the taxpayer's current employment, or it has a relevant connection to the taxpayer's income earning activities.³⁶</p> <p>Deduction Scope: The deduction includes expenses for accommodation and meals, computer consumables, tuition fees, purchase of equipment or technical means (cost \leq AUD 300), equipment maintenance cost, Internet use (excluding initial</p>

²⁵ Ibid.

²⁶ Ibid.

²⁷ 伍红、郑家兴, 《不同国家(地区)个人所得税专项扣除特点及启示》, Wu H & Zheng J, 'The Characteristics and Inspiration of Individual Income Tax Special Deduction in Different Countries (Regions)', (2019) *Taxation Research* 03, at 30-34.

²⁸ Ibid.

²⁹ Ibid.

³⁰ Above note 24.

³¹ 李华、蔡倩, 《个人所得税教育费用扣除的经验与借鉴》, Li H & Cai Q, 'International Experience of Education Deduction of Personal Income Tax', (2020) *Fiscal Science* 01, at 39-46.

³² Ibid.

³³ Above note 27.

³⁴ Above note 24.

³⁵ Above note 31.

³⁶ Above note 24.

	installation fee), parking fee (only applicable to education-related), telephone and Postal Stationery cost, student union membership fee, student service and facilities fee, textbook. ³⁷
Hong Kong	<p>Deduction prerequisite: the courses or examinations must be related to obtaining and maintaining qualifications that can apply to any employment.³⁸</p> <p>Deduction Scope: The deduction includes tuition fees and examination fees. Tuition fees relate to prescribed educational courses provided by specified educational providers, and examination fees relate to examinations organised by educational providers, trade associations, professional associations or business associations.³⁹</p> <p>Note: If the employer subsidises full or partial tuition fees, the government (e.g. through the continuing education fund) or any other person or institution, only the remainder can be deducted. The maximum deduction limit for personal education expenses in 2018 is HK \$100,000.⁴⁰</p>
Germany	<p>Deduction Scope: First-time participation in vocational courses is regarded as vocational or on-the-job training. Tax residents can deduct up to Euro 4,000 based on actual expenses incurred.⁴¹</p> <p>The expenses include expenses directly related to training and further study (such as examination fees, purchase of professional books), transportation expenses and additional meal expenses incurred from attending the training.⁴²</p> <p>Note: The reimbursement is not deductible if a third-party funds the taxpayer's continuing education or the employer has already reimbursed for such expenses.⁴³</p>
The Netherlands	<p>Deduction Scope: Expenses for on-the-job learning and education incurred by tax residents can be deducted by applying for a deduction between Euro 500 to Euro 15,000 per year.⁴⁴</p> <p>The deduction includes expenses for the registration fee, application fee, examination fee, book fee, etc.⁴⁵</p>
Canada	<p>Deduction Scope: The higher education deduction was amended in 2017.⁴⁶ Before 2017, only the tuition fees are deductible from the personal income tax.⁴⁷ After 2017, the expenses for vocational training are also deductible, while the cost for books and transportation are no longer deductible for federal taxes.⁴⁸</p>

³⁷ Above note 27.

³⁸ Above note 27.

³⁹ Above note 27.

⁴⁰ Above note 27.

⁴¹ Above note 27.

⁴² Above note 27 & 24.

⁴³ Above note 27.

⁴⁴ Above note 27.

⁴⁵ Above note 27 & 31.

⁴⁶ Above note 24.

⁴⁷ Above note 24.

⁴⁸ Above note 24.

	Note: Canada's extra-curriculum refers to arts or sports courses. To claim a deduction, taxpayers must spend over 12 hours studying art or physical education per month. ⁴⁹
France	Deduction Scope: The adult's higher education expenses are deductible, and the student loans' interest is also deductible. ⁵⁰ Note: Interests incurred during the first five years of repayment are deductible. ⁵¹

After reviewing the existing literature about the policy (as introduced above), the author identified two significant gaps in the current studies. Firstly, no existing literature analysed the policy under the principles of good taxation put forward by Adam Smith. Secondly, no existing literature provided relevant legal provisions to compare the Continuing Education Deduction policy with similar policies in other jurisdictions. Therefore, in this article, the authors adopt the principles of good taxation developed by Adam Smith as the analytic framework to evaluate the effectiveness of the new Continuing Education Deduction Policy in China and explore potential areas for future improvement.

III. The Individual Income Tax System and Its Continuing Education Deduction Policy in China

China's Continuing Education Deduction policy results from the seventh Individual Income Tax Law reform.⁵² In order to provide an accurate evaluation of the effectiveness of such a policy, it is necessary to examine the policy in the unique historical context of the Chinese Income Tax laws.

3.1 An overview of the Individual Income Tax System in the PRC

Evolution of China's Individual Income Tax System (2003-2018)

The individual income tax system in the PRC was a typical schedular system, dividing individual income into several items and separately calculating taxes on different items.⁵³ On 14th October 2003, the Third Plenary Session of the 16th Central Committee of the Communist Party of China (CPC) released a decision on some issues concerning the improvement of the socialist market economy, including the reform of the individual income tax system in the PRC.⁵⁴ The *Constitution*⁵⁵ of the PRC highlighted the

⁴⁹ Above note 24.

⁵⁰ Above note 24.

⁵¹ Above note 24.

⁵² Above note 1.

⁵³ 高培勇, 《个税改革: 还是要加快向综合与分类结合制转轨》, Gao P, 'A Solo Feasible Solution for Personal Income Tax Reform: Accelerating to Integrate the Comprehensive Income Tax System With the Classified One', (2019) *Taxation Research* 01, at 30-33.

⁵⁴ 《中共中央关于完善社会主义市场经济体制若干问题的决定》 Decision of the Central Committee of the Communist Party of China on Some Issues concerning the Improvement of the Socialist Market Economy 2003 (Central Committee of the Communist Party of China).

⁵⁵ 《中华人民共和国宪法》 *Constitution of the People's Republic of China* 2018 (National People's Congress).

“leadership of the CPC is the essential feature of socialism with Chinese characteristics”.⁵⁶

Implementing global elements into the *Individual Income Tax Law*⁵⁷ has been mentioned in the Five-year Plan for Economic and Social Development of the People's Republic of China, especially from the Ninth Five-year Plan to the Thirteenth Five-year Plan.

In the PRC, a completely global tax system is not in line with the national conditions.⁵⁸ Many scholars highlighted the advantages of a mixed individual income tax system, for example Cui (2014)⁵⁹ and Gao (2008)⁶⁰. The mixed system has a better balancing function, which could drive income redistribution to narrow the wealth gap.

The PRC's State Taxation Administration made the first attempt on 6th November 2006. It released a *Notice*⁶¹ that requires taxpayers to complete a self-assessment. The self-assessment system stipulated that taxpayers who gain income from two or more sources and whose total income exceeds RMB 120,000⁶² must make a self-assessment according to their comprehensive income. The concept of comprehensive income represents the global elements in China's individual income tax.

The gradual improvement in tax administration between 2006 and 2018 enables the Chinese government attempts to design a mixed individual income tax system. After the amended *Individual Income Tax Law* promulgated,⁶³ the State Taxation Administration declared that the PRC has successfully established an individual income tax system that combines the schedular and global characteristics.⁶⁴

Final Settlement⁶⁵ in the PRC

The amended *Individual Income Tax Law*⁶⁶ highlighted that tax resident individuals in the PRC should complete a Final Settlement⁶⁷ between 1st March and 30th June of the

⁵⁶ Ibid, Art 1.

⁵⁷ Above note 1.

⁵⁸ 杨斌, 《西方模式个人所得税的不可行性和中国式个人所得税的制度设计》, Yang B, 'The Infeasibility of Western Personal Income Tax System and the System Design in China', (2002) *Management World* 07, at 11-23.

⁵⁹ 崔军、朱晓璐, 《论综合与分类相结合计征方式下的我国个人所得税改革》, Cui J & Zhu X, 'Personal Income Tax Reform in China: An Integration and Classification Combined Approach', (2014) *Taxation Research* 09, at 24-30.

⁶⁰ Above note 53.

⁶¹ 《国家税务总局关于印发〈个人所得税自行纳税申报办法(试行)〉的通知》 Notice of the State Taxation Administration on Printing and Distributing the Measures for Self-declaration of Individual Income Tax (Trial) 2006 (State Taxation Administration).

⁶² This is approximately AUD 24,000. The current exchange rate between RMB and AUD is approximately 5:1.

⁶³ Above note 2.

⁶⁴ 国家税务总局所得税司, 《年度汇算: 个税改革全面落地的关键一步》, Income Department of the State Taxation Administration, 'Final Settlement: The Most Important Step of Individual Income Tax Law Reform', (2020) *China Taxation* 04, at 29-32.

⁶⁵ 汇算清缴.

⁶⁶ Above note 1.

⁶⁷ Above note 1.

following fiscal year.⁶⁸ The Final Settlement⁶⁹ is based on the individual's comprehensive income.

Final settlement is a new concept for individuals and tax administrators in the PRC, but it has existed for a long time in other countries. For example, in Australia, resident individuals are required to lodge a tax return after the end of each fiscal year. They will receive a Notice of Assessment⁷⁰ from the Australian Taxation Office (ATO). The Notice of Assessment is "an itemized account of the amount of tax resident individuals owe on their taxable income, and taxpayers are required to check everything on the notice".⁷¹ The final settlement also exists in the United States, the United Kingdom, New Zealand, etc.

Final settlement is an administrative method, it is not the only taxing point for the individual income tax. Taxpayers' tax liabilities incurred when their income is derived.⁷² The first Final Settlement⁷³ should be completed between 1st March 2020 and 30th June 2020, which is required by the *Guidance*⁷⁴ from the State Taxation Administration.⁷⁵

At first, the *Guidance*⁷⁶ distinguishes whether the taxpayer needs to complete a Final Settlement.⁷⁷ Taxpayers are required to complete a Final Settlement,⁷⁸ if they meet the following criteria:

"(1) The amount of tax prepaid in 2019 is greater than the annual tax payable and applies for tax refund. It includes: the comprehensive income of 2019 does not exceed 60,000RMB,⁷⁹ but the individual income tax has been paid in advance; the withholding rate applicable to the annual intermediate service remuneration, remuneration and royalty is higher than the annual applicable tax rate of comprehensive income; when the tax is prepaid, the deduction of expenses, special deduction, special additional deduction, other deduction or donation determined according to law are not declared or not fully deducted, and not declared Enjoy or not fully enjoy the comprehensive income tax preference.

(2) In 2019, the comprehensive income exceeds 120,000RMB⁸⁰ and the amount of tax to be paid exceeds 400RMB.⁸¹ Moreover, the comprehensive income comes from two or more places, which applies a higher tax rate and result in the prepaid tax less than the annual tax payable".⁸²

⁶⁸ Above note 1, Art 11.

⁶⁹ Above note 65.

⁷⁰ Part IV, Income Tax Assessment Act 1936.

⁷¹ Australian Taxation Office, 'Your Notice of Assessment', <<https://www.ato.gov.au/individuals/lodging-your-tax-return/in-detail/your-notice-of-assessment>> (13 Nov. 2020).

⁷² 马珺, 《个人所得税综合所得年度汇算清缴的理论与实践问题》, Ma J, 'On the Annual Individual Income Tax Settlement of Comprehensive Income', (2020) *International Taxation in China* 03, at 6-14.

⁷³ Above note 65.

⁷⁴ 《国家税务总局关于办理 2019 年度个人所得税综合所得汇算清缴事项的公告》 Announcement of the State Taxation Administration on Matters Concerning Personal Income Tax Consolidated Income Final Settlement and Payment in 2019 (State Taxation Administration).

⁷⁵ Ibid.

⁷⁶ Ibid.

⁷⁷ Above note 65.

⁷⁸ Above note 65.

⁷⁹ This is approximately AUD 12,000.

⁸⁰ This is approximately AUD 24,000.

⁸¹ This is approximately AUD 80.

⁸² Above note 74.

Secondly, the *Guidance*⁸³ provides a simple formula to taxpayers. The formula could be used by taxpayers to calculate the difference between the amounts of final tax payable and withheld tax in 2019. The resulting difference is the amount of refundable or unpaid tax in 2019. The formula is as follows:⁸⁴

Refundable or Unpaid Tax

$$= [(Comprehensive\ Income - Tax\ Free\ Threshold - Special\ Deductions - Special\ Additional\ Deductions - Other\ Deductions) \times Applicable\ Tax\ Rate - Quick\ Deduction] - Tax\ Withheld\ in\ 2019$$

Tax Assessment for Resident Individuals in the PRC

The current individual income tax system in the PRC has schedular and global characteristics. This can be reflected in the tax assessment for resident individuals. Firstly, income from different sources is taxed separately. The progressive tax rates are applied to comprehensive income and income from business operations; and a flat tax rate (twenty per cent) is applied to income from interest, dividends, bonuses, lease of property, transfer of property and incidental income.⁸⁵

Article 22 of the *Individual Income Tax Law*⁸⁶ outlines two schedules of progressive individual income tax rates in the PRC. Schedule 1 is applicable to comprehensive income, which ranges from five per cent to forty-five per cent.⁸⁷ The yearly tax-free threshold is RMB 60,000.⁸⁸ Schedule 2 is applicable to income from business operations, which ranges from five per cent to thirty-five per cent.⁸⁹

Table 3-1⁹⁰ Schedule 1: Individual Income Tax Rates (Applicable to Comprehensive Income)

Bracket	Annual taxable income	Tax rate (%)
1	Income of RMB 36,000 or less	3%
2	The part of income between RMB 36,000 to 144,000	10%
3	The part of income between RMB 144,000 to 300,000	20%
4	The part of income between RMB 300,000 to 420,000	25%
5	The part of income between RMB 420,000 to 660,000	30%
6	The part of income between RMB 660,000 to 960,000	35%
7	The part of income in excess of RMB 960,000	45%

⁸³ Above note 74.

⁸⁴ Above note 74.

⁸⁵ Above note 1, Art 3.

⁸⁶ Above note 1.

⁸⁷ Above note 1, Art 22.

⁸⁸ This is approximately AUD 12,000.

⁸⁹ Above note 1, Art 22.

⁹⁰ Adapted from 《中华人民共和国个人所得税法》 *Law of the People's Republic of China on Individual Income Tax* 2018 (Standing Committee of the National People's Congress), Art 22, Schedule 1.

Table 3-2⁹¹ Schedule 2: Individual Income Tax Rates (Applicable to Income from Business Operation)

Bracket	Annual taxable income	Tax rate (%)
1	Income of RMB 30,000 or less	5%
2	The part of income between RMB 30,000 to 90,000	10%
3	The part of income between RMB 90,000 to 300,000	20%
4	The part of income between RMB 300,000 to 500,000	30%
5	The part of income in excess of RMB 500,000	35%

Secondly, the concept of comprehensive income reflects global characteristics. In the PRC, the comprehensive income consists of the following four categories: income from wages and salaries, income from “labour remunerations”,⁹² income from author’s remuneration, and income from royalties.⁹³ For a tax resident, the amount of taxable income is calculated as:⁹⁴

$$\begin{aligned}
 & \text{Taxable Income (Applicable to Comprehensive Income)} \\
 &= \text{Comprehensive Income} - \text{Tax Free Threshold} \\
 &\quad - \text{Special Deductions} - \text{Special Additional Deductions} \\
 &\quad - \text{Other Deductions}
 \end{aligned}$$

This study focuses on the Continuing Education Deduction policy in the PRC relating to the comprehensive income gained by taxpayers, so Schedule 1 individual income tax rates are applicable in this study; it can be translated into the following table based on taxpayer’s comprehensive income.

Table 3-3 Translated from Schedule 1: Individual Income Tax Rates (Applicable to Comprehensive Income)

Bracket	Comprehensive Income (RMB) Floor	Comprehensive Income (RMB) Ceiling	Marginal Rate	Tax on This Income
0	0	60,000	Nil	Nil
1	60,001	96,000	3%	RMB 0.03 for each RMB 1 over RMB 60,000
2	96,001	204,000	10%	1080 plus RMB 0.10 for each 1 over RMB 96,000
3	204,001	360,000	20%	RMB11,880 plus RMB 0.20 for each RMB 1 over RMB 204,000

⁹¹ Adapted from 《中华人民共和国个人所得税法》 *Law of the People's Republic of China on Individual Income Tax* 2018 (Standing Committee of the National People’s Congress), Art 22, Schedule 2.

⁹² Equivalent to the concept of “income from personal services” in Australia.

⁹³ Above note 1, Art 2.

⁹⁴ Above note 1, Art 6.

4	360,001	480,000	25%	RMB 43,080 plus RMB 0.25 for each RMB 1 over RMB 360,000
5	480,001	720,000	30%	RMB 73,080 plus RMB 0.30 for each RMB 1 over RMB 480,000
6	720,001	1,020,000	35%	RMB 145,080 plus RMB 0.35 for each RMB 1 over RMB 720,000
7	1,020,001	over	45%	RMB 250,080 plus RMB 0.45 for each RMB 1 over RMB 1,020,000

3.2 An Overview of the Continuing Education Deduction Policy in the PRC

The Continuing Education Deduction policy arose from the seventh amendment of the *Individual Income Tax Law*.⁹⁵ The *Interim Measures for Special Additional Deductions for Individual Income Tax (Interim Measures)*⁹⁶ and the *Operating Measures for Special Additional Deduction for Individual Income Tax (Trial) (Operating Measures)*⁹⁷ outline its policy details. These three legal documents stipulate the current scope, standards and implementation methods of the Continuing Education Deduction in the PRC. The Interim Measure⁹⁸ stipulates the deduction scope and standards; the Operating Measures⁹⁹ stipulates the deduction claiming steps.

According to the *Legislation Law of the People's Republic of China (Legislation Law)*,¹⁰⁰ the source of law includes five levels: the *Constitution*¹⁰¹, laws, administrative regulations, rules and regulatory documents.¹⁰² The *Interim Measure*¹⁰³ was issued by the State Council, and it has legal effect as the level of administrative regulations; the

⁹⁵ Above note 1.

⁹⁶ 《个人所得税专项附加扣除暂行办法》 Interim Measures for Special Additional Deductions for Individual Income Tax 2018 (State Council).

⁹⁷ 《个人所得税专项附加扣除操作办法(试行)》 Operating Measures for Special Additional Deduction for Individual Income Tax (Trial) 2018 (State Taxation Administration).

⁹⁸ Above note 96.

⁹⁹ Above note 97.

¹⁰⁰ 《中华人民共和国立法法》 *Legislation Law of the People's Republic of China* 2015 (National People's Congress).

¹⁰¹ Above note 55.

¹⁰² Wang S, Zhao J, Nan X & Huang E, 'The Source of Tax Law in the PRC: Legislative Organs and Their Legal Documents', (2019) *Journal of Chinese Tax and Policy* vol.9: Issue 2.

¹⁰³ Above note 96.

*Operating Measures*¹⁰⁴ was issued by the State Taxation Administration, and it has legal effect as the level of rules.¹⁰⁵ They both are legally binding for taxpayers in the PRC.¹⁰⁶

Law of the People's Republic of China on Individual Income Tax¹⁰⁷

Article 6 of the *Individual Income Tax Law*¹⁰⁸ states that expenses for continuing education are deductible as a special addition deduction for tax residents. The provisions are as follows:

“(1) With respect to the comprehensive income gained by a resident individual, the amount of taxable income shall be the part remaining after the deduction of the cost of RMB60,000 as well as special deduction, special additional deduction and other deductions determined in accordance with the law from the amount of income in a tax year...; special additional deductions shall include expenditures on children's education, continuous education, treatment for serious diseases, interest on housing loan or housing rental, and support for the elderly, etc. and specific scope, standards and steps shall be determined by the State Council and submitted to the Standing Committee of the National People's Congress for record-filing.”¹⁰⁹

Article 6 stipulates that tax residents have a right to claim Special Additional Deductions including expenses for receiving continuing education, however there are no detailed provisions about the relevant scope, standard and operating measures. Article 6 provided that the State Council of the PRC determines its policy details.¹¹⁰

After the amended *Individual Income Tax Law*¹¹¹ was promulgated on 31st August 2018, the *Interim Measures*¹¹² and *Operating Measures*¹¹³ were promulgated successively. Although both are temporary documents¹¹⁴, they are legally binding for taxpayers in the PRC.

Interim Measures for Special Additional Deductions for Individual Income Tax

The *Interim Measures*¹¹⁵ is formulated in accordance with the *Individual Income Tax Law*,¹¹⁶ which was promulgated by China's State Council on 13th December 2018 and

¹⁰⁴ Above note 97.

¹⁰⁵ For more details about China's source of law for Taxation, please see: Wang S, Zhao J, Nan X & Huang E, 'The Source of Tax Law in the PRC: Legislative Organs and Their Legal Documents', (2019) *Journal of Chinese Tax and Policy* vol.9: Issue 2.

¹⁰⁶ Ibid.

¹⁰⁷ Above note 1.

¹⁰⁸ Above note 1.

¹⁰⁹ Above note 1, Art 6.

¹¹⁰ Above note 1, Art 6.

¹¹¹ Above note 1.

¹¹² Above note 96.

¹¹³ Above note 97.

¹¹⁴ Above note 100, Arts 9, 80 & 82.

¹¹⁵ Above note 96.

¹¹⁶ Above note 1.

came into effect on 1st January 2019.¹¹⁷ It defined the scope, standards and principles of the Continuing Education Deduction policy.

Firstly, Article 3 of the *Interim Measures*¹¹⁸ stated that the Special Additional Deduction policies shall comply with the principles of fairness, reasonableness, good for the people's livelihood and convenient for implementation.¹¹⁹ As one of the Special Additional Deduction policies, the Continuing Education Deduction policy should follow these principles as well.

Secondly, Article 7 of the *Interim Measures*¹²⁰ defined the scope of the Continuing Education Deduction policy. The deductible items include continuing education for academic qualification (degree) and vocational qualification. The scope of academic qualification refers to relevant qualifications or degrees within China; and the scope of vocational qualification refers to relevant qualifications for skilled personnel and specialized technicians.¹²¹

Thirdly, Article 7 of the *Interim Measures*¹²² defined the standard for the Continuing Education Deduction policy. Resident individuals could claim RMB 4,800¹²³ per year as a special additional deduction when they gain continuing education for academic qualification (degree), but the study length should not exceed 48 months. Resident individuals also could claim RMB 3,600¹²⁴ in the fiscal year when they obtained a certificate for “skilled-personnel”¹²⁵ or “specialized-technician”¹²⁶ vocational qualifications.

Operating Measures for Special Additional Deduction for Individual Income Tax (Trial)

The Operating Measures¹²⁷ is formulated in accordance with the *Individual Income Tax Law*,¹²⁸ the *Interim Measures*¹²⁹ and the Law of the People's Republic of China on the Administration of Tax Collection (Tax Collection Administration Law).¹³⁰ The Operating Measures¹³¹ stipulates implementation methods for tax residents to enjoy the Continuing Education Deduction policy.

¹¹⁷ Above note 96.

¹¹⁸ Above note 96.

¹¹⁹ Above note 96, Art 3.

¹²⁰ Above note 96.

¹²¹ Above note 96, Art 7.

¹²² Above note 96.

¹²³ This is approximately AUD 960.

¹²⁴ This is approximately AUD 720.

¹²⁵ “Skilled-personnel” is better translated as “technician”.

¹²⁶ “Specialized-technician” is better translated as “professional”.

¹²⁷ Above note 97.

¹²⁸ Above note 1.

¹²⁹ Above note 97.

¹³⁰ 《中华人民共和国税收征收管理法》 *Law of the People's Republic of China on the Administration of Tax Collection* 2015 (Standing Committee of the National People's Congress).

¹³¹ Above note 97.

Firstly, Article 3 of the *Operating Measures*¹³² further explained the study length about continuing education, although it has been emphasized by the *Interim Measures*.¹³³ The provisions are as follows:

“(2) Continuing education. The time period in case of continuing education for diploma (degree) shall be from the month of enrolment for acceptance of continuing education for diploma (degree) within China to the month when the continuing education for diploma (degree) is completed with the deducted time period for the same continuing education for diploma (degree) not exceeding 48 months. For the continuing education for occupational qualification for skilled persons or the continuing education for occupational qualification for professional technical persons, it shall be the year of receipt of relevant certificate”.¹³⁴

Secondly, Article 4 of the *Operating Measures*¹³⁵ highlighted that repeat declaration is prohibited.¹³⁶ When taxpayers obtained wage or salary from two or more sources, they need to make a choice to claim the deduction regarding the same item.¹³⁷

Thirdly, Article 14 of the *Operating Measures*¹³⁸ provided that taxpayers need to submit information when they are eligible to enjoy the Continuing Education Deduction policy. A tax resident individual who gains continuing education for academic qualifications (degrees) is required to fill out and submit information including: the starting time and ending time of the education and the stage of the education; a tax resident individual who gains continuing education for vocational qualifications is required to fill out and submit information including: the name of the certificate, serial number of the certificate, the certificate issuing authority and date.¹³⁹

Fourthly, Article 19 of the *Operating Measures*¹⁴⁰ provides several methods of information submission. Taxpayers in the PRC could choose to claim the deduction through their withholding agents within the fiscal year.¹⁴¹ They also could choose to claim the deduction at the time of Final Settlement¹⁴² in following the fiscal year.¹⁴³ Either way, taxpayers could

“submit the information on special additional deductions for individual income tax to the withholding agent or the competent tax authority via the APP for remote handling of tax or the method such as electronic version or hard copy of statements”.¹⁴⁴

The authors next apply Adam Smith’s four principles of good taxation design, namely, convenience, certainty, economy and equality, to evaluate the effectiveness of China’s Continuing Education Deduction Policy.

¹³² Above note 97.

¹³³ Above note 96.

¹³⁴ Above note 97, Art 3.

¹³⁵ Above note 97.

¹³⁶ Above note 97, Art 4.

¹³⁷ Above note 97, Art 4.

¹³⁸ Above note 97.

¹³⁹ Above note 97, Art 14.

¹⁴⁰ Above note 97.

¹⁴¹ Above note 97, Art 19.

¹⁴² Above note 65.

¹⁴³ Above note 97, Art 21.

¹⁴⁴ Above note 97, Art 19.

IV. Achievements: ‘Convenience’, ‘Equality’ and ‘Economy’ of China’s Continuing Education Deduction Policy

As introduced above, Adam Smith’s four principles of good taxation design are ‘convenience’, ‘certainty’, ‘economy’ and ‘equality’.¹⁴⁵ This section particularly examines ‘convenience’, ‘equality’ and ‘economy’ aspects of the Continuing Education Deduction policy in the PRC.

More specifically, Section 4.1 evaluates the convenience of the Continuing Education Deduction policy. Adam Smith believed that a good tax system design “ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it”.¹⁴⁶ Some researchers refer to this criterion as simplicity.¹⁴⁷ No matter what terminology is used, a good tax system should allow taxpayers to pay taxes conveniently.

Section 4.2 evaluates the equality of the Continuing Education Deduction policy. Adam Smith highlighted that individuals “are all obliged to contribute in proportion to their respective interests in the estate”.¹⁴⁸ Some researchers refer to this criterion as fairness.¹⁴⁹ No matter what terminology is used, a good tax system should allow taxpayers to pay taxes based on their financial ability.

Section 4.2 also evaluates the “economy” of the Continuing Education Deduction policy. Adam Smith highlighted that a good tax should be “contrived as both to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state”.¹⁵⁰ Some researchers refer to this criterion as efficiency.¹⁵¹ No matter what terminology is used, a good tax system should have limited tax levying costs and not hinder the efficiency of resource allocation.

4.1 ‘Convenience’

A good tax system should allow taxpayers to pay taxes conveniently. This section discusses the convenience of the Continuing Education Deduction policy with respect to its deduction standards and operating measures. This section applies qualitative methodology, including textual analysis. The textual analysis is used to review the *Interim Measures for Special Additional Deductions for Individual Income Tax (Interim Measures)*¹⁵² and the *Operating Measures for Special Additional Deduction for Individual Income Tax (Trial) (Operating Measures)*.¹⁵³

¹⁴⁵ Smith A, *The Wealth of Nations*, (Tustin: Xist Publishing, 2015), at 616-619.

¹⁴⁶ *Ibid.*

¹⁴⁷ Coleman C, & others, *Australian Tax Analysis: Cases, Commentary, Commercial Applications and Questions*, (Sydney: Thomson Reuters, 8th ed, 2011), at 6-7.

¹⁴⁸ Above note 145.

¹⁴⁹ Above note 147.

¹⁵⁰ Above note 145.

¹⁵¹ Huang E, ‘Taxing Higher Education—Heecs/Fee-Heecs-Help Repayments as A Tax and Its Effects on The Progressive Tax Rate’, (2010) *IJAISL* 12.

¹⁵² 《个人所得税专项附加扣除暂行办法》 *Interim Measures for Special Additional Deductions for Individual Income Tax 2018 (State Council)*.

¹⁵³ 《个人所得税专项附加扣除操作办法(试行)》 *Operating Measures for Special Additional Deduction for Individual Income Tax (Trial) 2018 (State Taxation Administration)*.

The Continuing Education Deduction policy was criticised as too simple,¹⁵⁴ especially the deduction standard. The *Interim Measures*¹⁵⁵ stated that tax residents could claim a fixed amount of RMB 400 per month when they gained continuing education for academic qualification (degree); and they could claim a fixed amount of RMB 3,600 in the fiscal year when they gained continuing education for vocational qualification.¹⁵⁶ The deductible amount is fixed for each type of continuing education in the PRC.

For tax residents, a fixed deduction amount cannot reflect their actual expenditures on continuing education, but it is very convenient; since they do not need to collect relevant invoices or payment proofs as evidence and determine which costs are eligible for the Continuing Education Deduction policy. Please note the only forms of evidence required are the type and certificate of the relevant qualification.¹⁵⁷

Article 13 of the *Operating Measures*¹⁵⁸ highlighted that taxpayers need to submit information when they are eligible to claim the Continuing Education Deduction.¹⁵⁹ Article 19 stated that taxpayers could submit the information to withholding agents or relevant tax authorities through “the App¹⁶⁰ for remote handling of tax or the method such as electronic version or hard copy of the Statement¹⁶¹”.¹⁶² The PRC’s government allows taxpayers to declare Special Additional Deductions through various digital channels, which is convenient for taxpayers.

One of these digital channels is the Electronic Tax Bureau of Natural Persons (Electronic Tax Bureau). It was launched on 1st January 2020 as an online self-assessment system. The Electronic Tax Bureau has several functions, including personal information registration, special additional deduction information collection, business income declaration, declaration correction and cancellation, filing query, tax payment, income tax details inquiry, etc.¹⁶³

According to the functions, taxpayers could claim the Continuing Education Deduction through the Electronic Tax Bureau. Taxpayers could access to the Electronic Tax Bureau through the following three channels: “website terminal” (Web page), “mobile phone terminal” (App) and the terminal for withholding agents (Software).

Firstly, the Electronic Tax Bureau supports more application scenarios. In the 21st century, people tend to complete shopping, payment and other daily chores through mobile devices. Mobile devices could support more application scenarios, thus allowing

¹⁵⁴ 张凯迪, 《个人所得税教育专项扣除的国际经验借鉴与比较》, Zhang K, ‘The Reference and Comparison of The International Experience of the Special Additional Deduction on Individual Income Tax Law’, (2018) *Fiscal Science* 12, at 147-153.

¹⁵⁵ Above note 96.

¹⁵⁶ Above note 96, Art 7.

¹⁵⁷ Please see detailed discussion of the *Operating Measures* in Section 3.3.

¹⁵⁸ Above note 97.

¹⁵⁹ Above note 97, Art 13.

¹⁶⁰ App: 个人所得税.

¹⁶¹ 扣除信息表.

¹⁶² Above note 153, Art 19.

¹⁶³ 《关于自然人电子税务局上线的通告》 *Notice on the Launch of Electronic Tax Bureau of Natural Persons* 2018 (State Taxation Administration of Fujian).

taxpayers to declare the Continuing Education Deduction through the Web page and the App is very convenient for taxpayers in the PRC.

Secondly, as an online self-assessment system, the Electronic Tax Bureau provides relevant guidance when taxpayers submit information for the Continuing Education Deduction. Taxpayers could follow the guidance to evaluate the deductible items and calculate deductible expenses by themselves, which is convenient.

The Continuing Education Deduction policy is convenient for taxpayers' compliance due to its deduction standards and operating measures. Firstly, the deduction standard is convenient for taxpayers. They could claim a fixed amount deduction according to the type of continuing education they gained. Secondly, they could claim the Continuing Education Deduction through several digital channels, which is convenient for different application scenarios.

Although the current self-assessment system is convenient for taxpayers, it could be further improved by information exchange among government departments in the PRC. Through this information exchange, information pre-filing for resident taxpayers could be enabled in the self-assessment system.

4.2 'Equality' and 'Economy'

The criterion of equality requires that individuals “are all obliged to contribute in proportion to their respective interests in the estate”, and the criterion of economy requires that a good tax system should be “contrived as both to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state”.¹⁶⁴ This section discusses the equality and economy of the Continuing Education Deduction policy through a tax economic analysis.

This section applies quantitative methodology, including a microeconomic tax analysis model to calculate the average tax rate (ATR) and the effective marginal tax rate (EMTR). The strength of applying economic modelling is the replicability of research. Many journals encourage authors to provide a detailed description of the research data source and research procedures, which make other researchers replicate the research in different contexts.¹⁶⁵ At present, the details of the Continuing Education Deduction policy are released in the *Interim Measures*¹⁶⁶ and *Operating Measures*.¹⁶⁷ When these interim provisions change, this replicable method can also be used in future studies.

The applied microeconomic model has been adopted by many scholars. Apps¹⁶⁸ stated that the ATR and the EMTR are two important factors to determine whether a tax policy meets the criteria of equality and economy (efficiency).

¹⁶⁴ Above note 145.

¹⁶⁵ Edward J, 'Why journal editors should encourage the replication of applied econometric research.' (1984) *Quarterly Journal of Business and Economics* 3-8.

¹⁶⁶ Above note 96.

¹⁶⁷ Above note 97.

¹⁶⁸ Apps P, *LAWS 6257, Public Policy Course Readings*, (Sydney: The University of Sydney, 2009), at 147.

The ATR is an indicator for the equality of a tax system. The increase, maintenance and decrease of ATR respectively correspond to progressive, proportional or regressive tax systems.¹⁶⁹ This study calculates the ATR based on the following formula:

$$\text{Average Tax Rate (ATR)} = \frac{\text{Tax Payment (T)}}{\text{Taxable Income (Y)}}$$

The EMTR is an indicator for the efficiency of a tax system, where fluctuation of EMTR reflects whether the tax system is efficient. This study calculates the EMTR based on the following formula:

$$\text{Effective Marginal Tax Rate (EMTR)} = \frac{\Delta \text{Tax Payment (T)}}{\Delta \text{Taxable Income (Y)}}$$

Assumptions and Data Selection

Article 6 of the *Individual Income Tax Law*¹⁷⁰ stated that, for tax residents, taxable income is “the part remaining after the deduction of the cost of RMB 60,000 as well as special deduction, special additional deduction and other deductions determined in accordance with the law from the amount of income in a tax year”.¹⁷¹ As mentioned in Section III, this provision could be translated into the following formula:¹⁷²

$$\begin{aligned} \text{Taxable Income (Applicable to Comprehensive Income)} \\ &= \text{Comprehensive Income} - \text{Tax Free Threshold} \\ &\quad - \text{Special Deductions} - \text{Speical Additional Deductions} \\ &\quad - \text{Other Deductions} \end{aligned}$$

To highlight the impact of the Continuing Education Deduction policy, before calculations, this section makes assumptions as follows:

1. Taxpayers in China only earn comprehensive income;
2. There are only two deductions in the individual income tax system: the fixed cost deduction of RMB 60,000 and the Continuing Education Deduction;
3. All taxpayers who gain academic (degree) qualification continuing education, they studied for the full fiscal year, allowing them RMB 4,800 in deductions; and
4. All taxpayers who gain vocational qualification continuing education only obtains one certificate, allowing them RMB 3,600 in deductions.

The first assumption eliminates the impact from other types of income. The second assumption eliminates the impact from other deductions. The third assumption simplifies the different length of taxpayers’ study periods in a fiscal year. The fourth

¹⁶⁹ Above note 151.

¹⁷⁰ 《中华人民共和国个人所得税法》 *Law of the People's Republic of China on Individual Income Tax 2018* (Standing Committee of the National People’s Congress).

¹⁷¹ Above note 170, Art 6.

¹⁷² Above note 170, Art 6.

assumption simplifies the fact that taxpayers may obtain multiple qualifications (certificates) in a fiscal year.

This model takes the Continuing Education Deduction as the only variable, and other factors remain unchanged. This section considered the following scenarios:

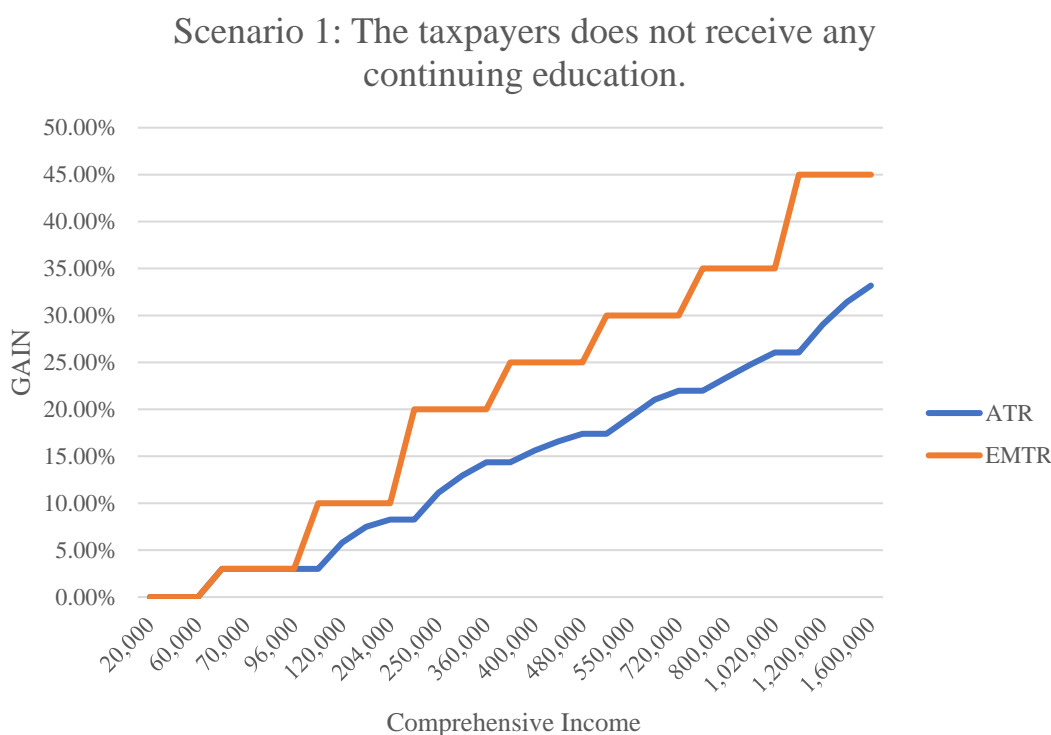
- Scenario 1: The taxpayer does not gain any continuing education;
- Scenario 2: The taxpayer only gains continuing education for academic (degree) qualification;
- Scenario 3: The taxpayer only gains continuing education for vocational qualification; and
- Scenario 4: The taxpayer gains both kinds of continuing education qualifications.

Calculation

Scenario 1: The taxpayer does not gain any continuing education.

Figure 6-1 presents ATR and EMTR results of scenario 1. It is clear that the ATR increases with the increase of comprehensive income. It indicates that when no taxpayer gains continuing education, therefore no one is claiming the deduction, China's individual income tax is progressive, which satisfied the principle of equality. Since no taxpayer is claiming the deduction, there is no effect on marginal tax rates, therefore the EMTR remains unchanged.

Figure 4-1 ATR and EMTR Based on Scenario 1 without Deductions

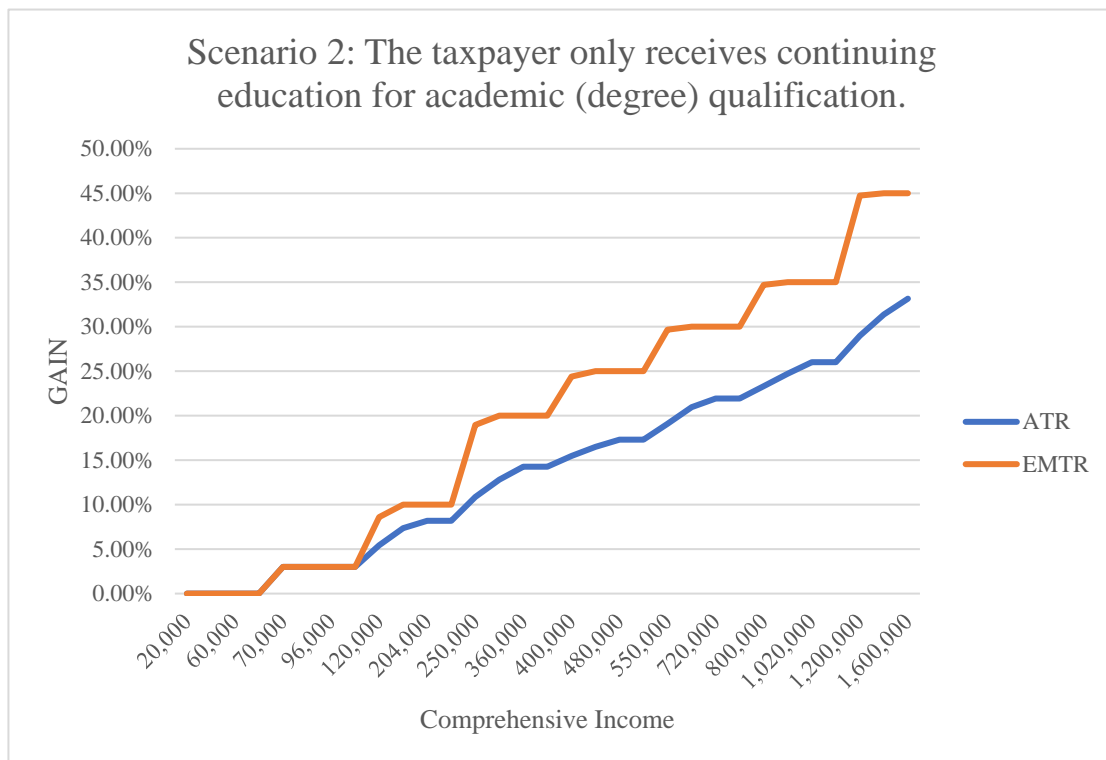


Scenario 2: The taxpayer only gains continuing education for academic (degree) qualification.

Figure 6-2 presents ATR and EMTR results of scenario 2. It is clear that the ATR increases with the increase of comprehensive income. It indicates that when taxpayers gain a full year of academic qualification (degree) continuing education, China's individual income tax is progressive, which satisfied the principle of equality.

The changes of EMTR is relatively consistent with the changes in nominal tax rate. Material changes in EMTR occurs when the deduction means the taxpayer moves down a bracket in the individual income tax rate scale. This is a foreseeable change and reflects that the deduction has reduced the taxpayer's tax burden, fulfilling the policy aim of this special additional deduction. The EMTR changes at a slightly different rate to that of the nominal marginal tax rate, exhibiting that the deduction has a greater impact at reducing the tax burden for lower income taxpayers. The deduction has not led to extraordinary tax leakages from the individual income tax system, because at the boundaries of each income bracket, the EMTR is lower than the nominal income tax rate.

Figure 4-2 ATR and EMTR Based on Scenario 2 with Continuing Education Deduction of Academic (Degree) Qualification



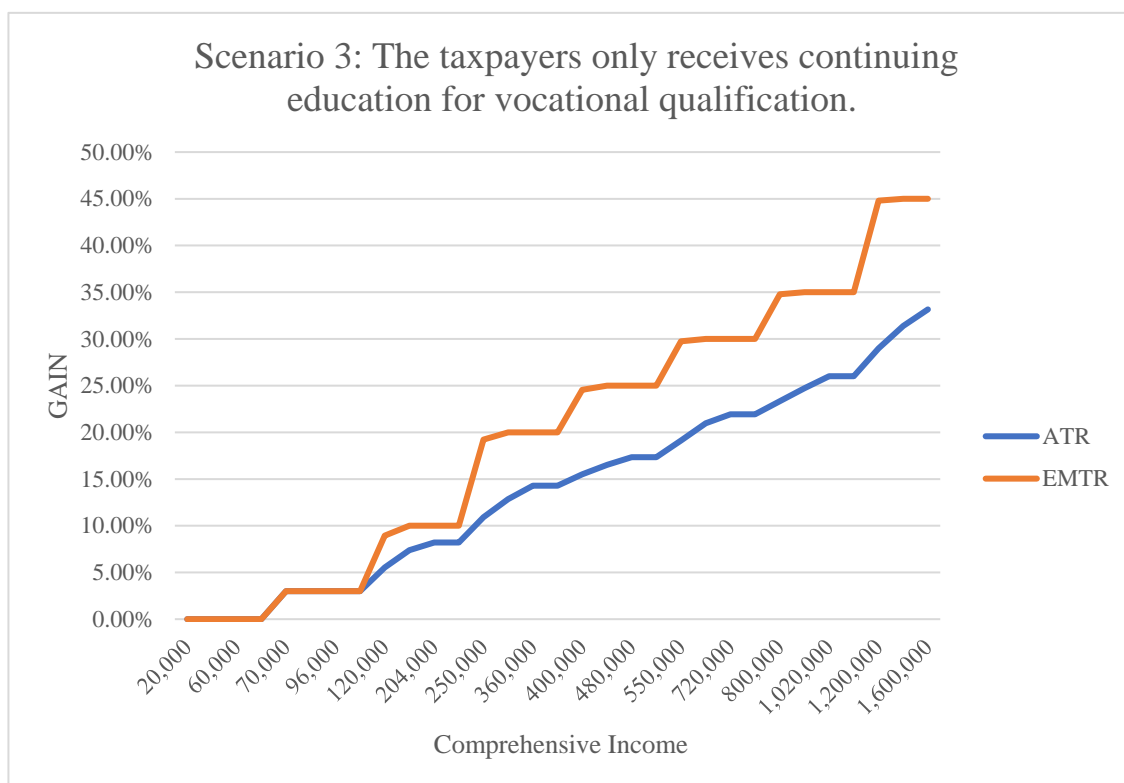
Scenario 3: The taxpayer only gains continuing education for vocational qualification.

Figure 6-3 presents ATR and EMTR results of scenario 3. It is clear that the ATR increases with the increase of comprehensive income. It indicates that when taxpayers

gain a full year of academic qualification (degree) continuing education, China's individual income tax is progressive, which satisfied the principle of equality.

The changes of EMTR is relatively consistent with the changes in nominal tax rate. Material changes in EMTR occurs when the deduction means the taxpayer moves down a bracket in the individual income tax rate scale. This is a foreseeable change and reflects that the deduction has reduced the taxpayer's tax burden, fulfilling the policy aim of this special additional deduction. The EMTR changes at a slightly different rate to that of the nominal marginal tax rate, exhibiting that the deduction has a greater impact at reducing the tax burden for lower income taxpayers. The deduction has not led to extraordinary tax leakages from the individual income tax system, because at the boundaries of each income bracket, the EMTR is lower than the nominal income tax rate.

Figure 4-3 ATR and EMTR Based on Scenario 3 with Vocational Qualification Continuing Education Deduction



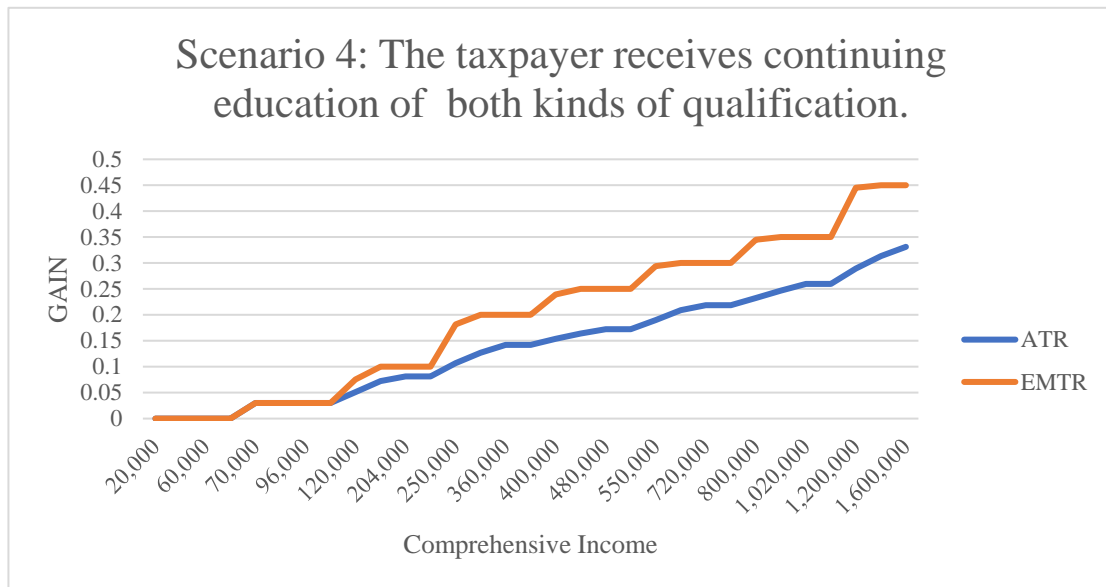
Scenario 4: The taxpayer gains both kinds of continuing education qualifications.

Figure 6-4 presents ATR and EMTR of scenario 4. It is clear that the ATR increases with the increase of comprehensive income. It indicates that when taxpayers gain a full year of academic qualification (degree) continuing education, China's individual income tax is progressive, which satisfied the principle of equality.

The changes of EMTR is relatively consistent with the changes in nominal tax rate. Material changes in EMTR occurs when the deduction means the taxpayer moves down a bracket in the individual income tax rate scale. This is a foreseeable change and

reflects that the deduction has reduced the taxpayer's tax burden, fulfilling the policy aim of this special additional deduction. The EMTR changes at a slightly different rate to that of the nominal marginal tax rate, exhibiting that the deduction has a greater impact at reducing the tax burden for lower income taxpayers. The deduction has not led to extraordinary tax leakages from the individual income tax system, because at the boundaries of each income bracket, the EMTR is lower than the nominal income tax rate.

Figure 4-4 ATR and EMTR Based on Scenario 4 with Both types of Continuing Education Deductions

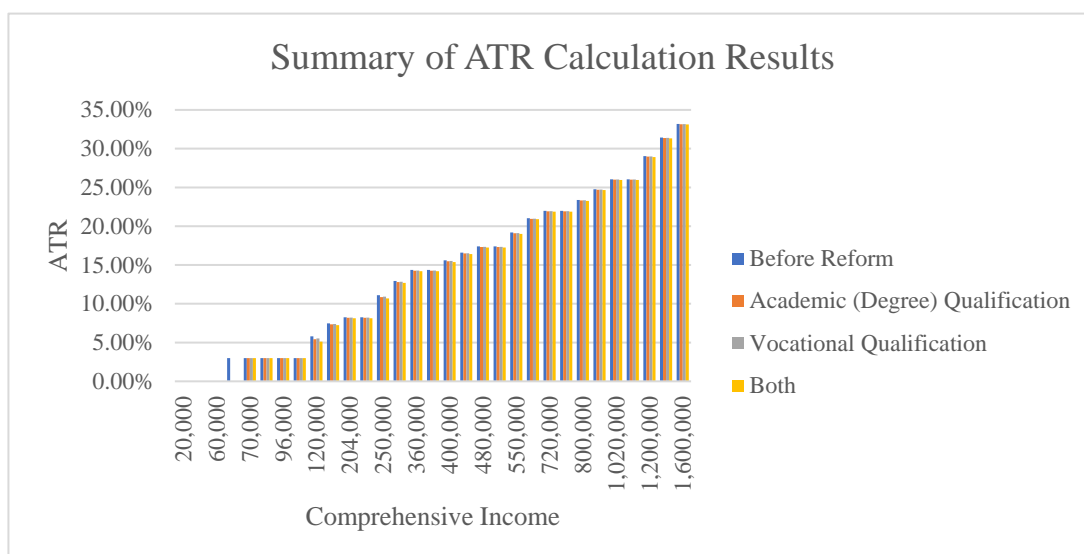


4.3 Conclusion and Remarks

According to above calculations, there are three conclusions. The first conclusion is that the Continuing Education Deduction policy could lead to tax burden reduction for taxpayers in the PRC. Figure 6-5 summarises all ATR calculation results for the four scenarios, which illustrates that the ART is lower for taxpayers after claiming the Continuing Education Deduction.

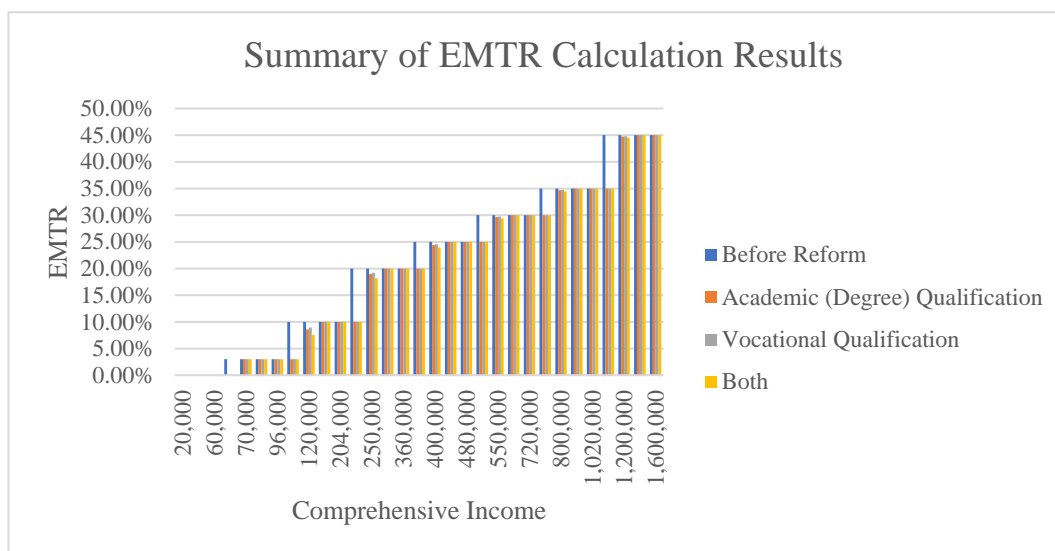
Secondly, it is clear that the ATR increases with the increase of comprehensive income for all four scenarios. It indicates that when taxpayers enjoy the Continuing Education Deduction policy, China's individual income tax is progressive, which satisfied the principle of equality.

Figure 4-5 Summary of ATR Calculation Results



Thirdly, the changes of EMTR is relatively consistent with the changes in nominal tax rate for all four scenarios. The EMTR changes at a slightly different rate to that of the nominal marginal tax rate, exhibiting that the deduction has a greater impact at reducing the tax burden for lower income taxpayers. The deduction has not led to extraordinary tax leakages from the individual income tax system, thus it does not affect the progressivity of individual income tax system, and it is still efficient.

Figure 4-6 Summary of EMTR Calculation Results



V. Challenge: ‘Certainty’ Issue in China’s Continuing Education Deduction Policy

In addition to ‘convenience’, ‘equality’ and ‘economy’, Adam Smith also highlighted the importance of tax certainty.¹⁷³ This section examines the ‘certainty’ issue of the Continuing Education Deduction policy in the PRC.

Regarding ‘certainty’, Adam Smith stated that “...each individual is bound to pay, ought to be certain and not arbitrary”,¹⁷⁴ which means a good tax system enables taxpayers to clearly understand their rights and tax liabilities. Fuller¹⁷⁵ stated that the “inner morality of law” requires that laws should be “clear” and “not arbitrary”.¹⁷⁶ A tax law that is “clear” and “not arbitrary” means it is certain for taxpayers to comply with and for tax authorities to administer.

Section 5.1 of this article explores the major challenges of implementing the new continuing education deduction policy in China by reflecting on the results from a qualitative case study that illustrated taxpayers’ confusion when claiming the Continuing Education Deduction through the Electronic Tax Bureau of Natural Persons (Electronic Tax Bureau).

Section 5.2 attempts to explore some practical solutions. It takes Australia’s work-related self-education deduction policy as an example of ‘policy certainty’ that may inform China’s further reform of the Continuing Education Deduction policy.

5.1 Challenges of Implementing the New Continuing Education Deduction Policy & Case Study on the Electronic Tax Bureau of Natural Persons in the PRC

This section applies a qualitative case study methodology, which observes from the Electronic Tax Bureau to demonstrate the procedures of claiming the Continuing Education Deduction. Case study has been applied in many research areas such as Sociology¹⁷⁷, Law¹⁷⁸ and Education.¹⁷⁹ It enables “a researcher to closely examine the data with a specific context”.¹⁸⁰ Case study does “not only help to explore or describe the data in real-life environment, but also help to explain the complexities of real-life situations which may not be captured through experimental or survey research”.¹⁸¹

The first reason to choose the Electronic Tax Bureau for case study purpose is that the Electronic Tax Bureau provides uniform procedures for tax resident individuals to claim the Continuing Education Deduction by themselves. Every Chinese tax resident individual can access the Electronic Tax Bureau through its “website terminal” (Web)¹⁸²

¹⁷³ Smith A, *The Wealth of Nations*, (Tustin: Xist Publishing, 2015), at 616-619.

¹⁷⁴ Ibid.

¹⁷⁵ Fuller L, *The Morality of Law*, (Yale University Press, 1969).

¹⁷⁶ Freeman M, *Lloyd's Introduction to Jurisprudence*, (Thomson Reuters, 9th ed, 2014), at 251.

¹⁷⁷ Grässel E & Schirmer B, ‘The Use of Volunteers to Support Family Carers of Dementia Patients: Results of A Prospective Longitudinal Study Investigating Expectations Towards and Experience with Training and Professional Support.’, (2006) *Zeitschrift für Gerontologie und Geriatrie* 39.3, at 217-226.

¹⁷⁸ Lovell G, ‘Justice excused: The deployment of law in everyday political encounters.’, (2006) *Law & Society Review* 40.2, at 283-324.

¹⁷⁹ Above note 177.

¹⁸⁰ Zainal Z, ‘Case study as a research method’, (2007) *Jurnal kemanusiaan* 9, at 1-6.

¹⁸¹ Ibid.

¹⁸² Web: 自然人电子税务局.

and “mobile phone terminal” (App).¹⁸³ All procedures in these two digital channels are uniform.¹⁸⁴

The second reason is that the Electronic Tax Bureau is user-friendly for taxpayers. In the 21st century, people tend to complete shopping, payment and other daily chores through computers or mobile devices. The Electronic Tax Bureau supports more application scenarios for taxpayers.

This case study has four steps to illustrate taxpayers' confusion when claiming the Continuing Education Deduction. Each step brings the taxpayer to a new page. Step 1 demonstrates the registration and login procedures; Step 2 demonstrates selecting the “Special Additional Deductions” option; Step 3 demonstrates the procedures to provide information about the Continuing Education Deduction; and Step 4 demonstrates the information submission procedure.

Step 1 Registration and Login

a. Access to the Electronic Tax Bureau.

The taxpayer can access the Electronic Tax Bureau through its Webpage or App. The Web address is <https://etax.chinatax.gov.cn/>, and the App is named “Individual Income Tax”. These two digital channels provide uniform procedures for tax resident individuals to claim Special Additional Deductions.

b. Register a personal account.

The taxpayer is required to register a personal account by using their citizen ID number, then the Electronic Tax Bureau requires a user's identification by face recognition and message verification code. Once the identification is verified, the taxpayer can set a password.

c. Enter the login interface.

d. Select citizen ID number or verified mobile phone number as account number and enter the password.

e. The Final Settlement¹⁸⁵ page would be shown after login.

Step 2 Choose <Claiming the Special Additional Deductions>

After logging into the Final Settlement page, there are several options on the page. The taxpayer needs to click the option named “Claiming the Special Additional Deductions”.

Step 3 Provide Continuing Education Deduction Information

a. Choose the year for the Special Additional Deduction.

b. Choose the type of Special Additional Deduction.

The Electronic Tax Bureau provides a list including all six Special Additional Deductions. This case study only focuses on the Continuing Education Deduction.

c. Collect personal information.

¹⁸³ App: 个人所得税.

¹⁸⁴ Although the Electronic Tax Bureau has a “terminal for withholding agents” (Software), it is not for tax reside individuals.

¹⁸⁵ 汇算清缴.

The taxpayer is required to provide personal information, including verified mobile phone number, E-mail address, and contact address.

- d. Choose the type of continuing education.

There are two options available for the taxpayer. One option is the continuing education for academic qualification (degree); the other is the continuing education for vocational qualification. The taxpayer needs to make a choice, but the taxpayer is unsure whether the education they gained falls into one of the continuing education categories; as the Electronic Tax Bureau does not provide guidance.

- e. When the taxpayer chooses the continuing education for academic qualification (degree).

The taxpayer is required to provide relevant information, including the level of academic qualification (degree) and the time when the continuing education begins and ends.

- f. When the taxpayer chooses the continuing education for vocational qualification.

There are two options available for the taxpayer. One is for vocational qualification of skilled personnel, and the other is for vocational qualification of specialized technicians. After that, the taxpayer is required to provide relevant information, including date of issue (approval), certificate ID, certificate name and issuing authority. The taxpayer needs to make a choice, but the taxpayer is unsure whether the education they gained is a recognised vocational education for the purposes of the deduction.

Step 4 Information Submission

The taxpayer could submit the information through withholding agents or by him/herself. If the taxpayer chooses to submit the information through withholding agents, the taxpayer is required to download the information from the Electronic Tax Bureau and transfer the information to his/her withholding agents. If the taxpayer chooses to submit information by him/herself, the taxpayer just clicks the option of “Self-declaration”.¹⁸⁶

According to the case study, at Step 4 (d), the taxpayer is unsure whether the education they gained falls into one of the continuing education categories as the Electronic Tax Bureau does not provide guidance. At Step 4 (f), the taxpayer is unsure whether the education they gained is a recognised vocational education for the purposes of the deduction.

5.2. ‘Certainty’ Issue in the Work-related Self-education Deduction Policy & Insights from Australia

Wu and Zheng’s article¹⁸⁷ suggested that the Continuing Education Deduction policy in the PRC is similar to the work-related self-education deduction policy in Australia. Both

¹⁸⁶ 自行申报.

¹⁸⁷ 伍红、郑家兴, 《不同国家(地区)个人所得税专项扣除特点及启示》, Wu H & Zheng J, ‘The Characteristics and Inspiration of Individual Income Tax Special Deduction in Different Countries (Regions)’, (2019) *Taxation Research* 410.

policies are concerned with taxpayers' education expenses. According to the discussion in Section 5.3, the reason behind Chinese taxpayers' confusion is the lack of policy detail.

In Australia, work-related self-education deduction is a general deduction. Many concepts in the policy are certain for taxpayers. Related laws are found in the *Income Tax Assessment Act 1936 (ITAA 1936)*,¹⁸⁸ the *Income Tax Assessment Act 1997 (ITAA 1997)*¹⁸⁹ and relevant case law.

Income Tax Assessment Act 1997 (ITAA 1997)¹⁹⁰

Section 8-1 of the *ITAA 1997*¹⁹¹ defines general deductions in Australia. Subsection (1) stipulates when taxpayers can claim a “loss or outgoing” as a deduction:

- “(a) it is incurred in gaining or producing your assessable income; or
- (b) it is necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income”.¹⁹²

Subsection (2) stipulates when taxpayers cannot claim a “loss or outgoing” as a deduction:

- “(a) it is a loss or outgoing of capital, or of a capital nature; or
- (b) it is a loss or outgoing of a private or domestic nature; or
- (c) it is incurred in relation to gaining or producing your exempt income or your non-assessable non-exempt income; or
- (d) a provision of this Act prevents you from deducting it”.¹⁹³

Income Tax Assessment Act 1936 (ITAA 1936)¹⁹⁴

Section 82A (1) of the *ITAA 1936* provides a right to taxpayers that:

“where a deduction is, or but for this section would be, allowable to the taxpayer under *section 8-1* of the *ITAA 1997* in respect of a year of income in respect of expenses of self-education, the deduction, or the aggregate of the deductions, so allowable to the taxpayer in respect of those expenses shall not be greater than the amount by which the net amount of expenses of self-education exceeds \$250”.¹⁹⁵

Section 82 A (2) of the *ITAA 1936*¹⁹⁶ provides clear definitions of key concepts in this section, which includes the definitions of “educational assistance”, “expenses of self-education”, “net amount of expenses of self-education” and “prescribed course of education”; with reference to more specific legislations.

¹⁸⁸ Income Tax Assessment Act 1936.

¹⁸⁹ Income Tax Assessment Act 1997.

¹⁹⁰ Ibid.

¹⁹¹ Formerly *ITAA 1936* subsection 51(1).

¹⁹² Above note 189, section 8-1 (1).

¹⁹³ Above note 189, section 8-1 (2).

¹⁹⁴ Above note 188.

¹⁹⁵ Above note 188, section 82A (1).

¹⁹⁶ Above note 188.

Section 82 A (2) defines “educational assistance” as:

“amounts (other than amounts in the nature of an allowance for maintenance or accommodation) payable under a scheme for the provision by the Commonwealth of assistance for secondary education, technical or tertiary education or post-graduate study”.¹⁹⁷

Section 82 A (2) defines “expenses of self-education”, with regard to different types of education and student, as:

“expenses necessarily incurred by the taxpayer for or in connection with a prescribed course of education but does not include:

(ba) a student contribution amount within the meaning of the *Higher Education Support Act 2003* paid to a higher education provider (within the meaning of that Act); or

(bb) a payment made in respect of, or in respect of the reduction or discharge of, any indebtedness to the Commonwealth under Chapter 4 of that Act; or

(bba) a payment made in respect of, or in respect of the reduction or discharge of, any indebtedness to the Commonwealth under Part 3A of the *VET Student Loans Act 2016*; or

(bc) a payment made in respect of, or in respect of the reduction or discharge of, any indebtedness to the Commonwealth under Chapter 2AA of the *Social Security Act 1991* or under Part 2 of the *Student Assistance Act 1973*; or

(bd) a payment made in respect of, or in respect of the reduction or discharge of, any indebtedness to the Commonwealth under the *Trade Support Loans Act 2014*; or

(be) a payment made in respect of, or in respect of the reduction or discharge of, any liability to overseas debtors repayment levy under the *Student Loans (Overseas Debtors Repayment Levy) Act 2015*; or

(c) a payment made in respect of, or in respect of the reduction or discharge of, any indebtedness to the Commonwealth or to a participating corporation under Chapter 2B of the *Social Security Act 1991* or Part 4A of the *Student Assistance Act 1973*”.¹⁹⁸

Section 82 A (2) defines “net amount of expenses of self-education” as:

“the amount ascertained by subtracting from the total amount of expenses of self-education incurred by the taxpayer in the year of income the sum of:

(a) any payment or payments of educational assistance that were capable of being claimed in the year of income by the taxpayer or by another person in respect of the taxpayer other than:

(i) a payment the amount of which has been, or will be, included in the assessable income of the taxpayer of any year of income; or

(ii) a payment that was capable of being claimed in a preceding year of income; and

(b) any payment or payments (other than a payment the amount of which has been, or will be, included in the assessable income of the taxpayer of any year of income) received by the taxpayer, or that the taxpayer was entitled to receive, in the year of income, from the taxpayer's employer, or from any other person, in respect of:

(i) expenses of self-education that were incurred by the taxpayer during the year of income; or

(ii) expenses of self-education in respect of which a deduction has been allowed, or is allowable, or in respect of which a rebate of tax has been allowed, or is allowable, in an assessment in respect of income derived by the taxpayer in a preceding year of income”.¹⁹⁹

¹⁹⁷ Above note 188, section 82A (2).

¹⁹⁸ Above note 188, section 82A (2).

¹⁹⁹ Above note 188, section 82A (2).

Section 82 A (2) defines “prescribed course of education” as:

“a course of education provided by a school, college, university or other place of education, and undertaken by the taxpayer for the purpose of gaining qualifications for use in the carrying on of a profession, business or trade or in the course of any employment”.²⁰⁰

*Leading Australian Tax Cases*²⁰¹

The *ITAA 1997*²⁰² and *ITAA 1936*²⁰³ provide details of the Work-related Self-education Deduction policy. Although there is statutory detail in the policy, some legal issues still arose from their application. Decisions from judges in case law bring application certainty to these details, removing any confusion felt by taxpayers.

*FCT v Finn*²⁰⁴

*Finn's Case*²⁰⁵ is a leading tax case regarding self-education expenses. Finn was a senior design architect employed by the Department of Public Works in Western Australia.²⁰⁶ During his long service, he accumulated leave, so he took a trip to the UK and the European continent to bring him up to date with current trends in architecture, and his employers asked him to extend the trip to South America and covered the additional costs incurred by this extension.²⁰⁷

The High Court allowed Finn a deduction for the outgoings. The judgement was delivered by Dixon CJ, Kitto J and Windeyer J.

Dixon CJ highlighted that,

“...the question for decision is whether the taxpayer is entitled to a deduction from his assessable income for the year ending 30th June 1957 of certain costs of travelling abroad”.²⁰⁸

His Honour held that,

“...incurred the expenses of travelling in order the better to fit himself to perform the work which the Western Australian Government required of him, and therefore he became entitled to deduct them under the first limb of s. 51 (1) which provides that all losses and outgoings to the extent they are incurred in gaining or producing the assessable income shall be allowable deductions”.²⁰⁹

Kitto and Windeyer JJ both highlighted the direct matching relationship between “assessable income” and “outgoing incurred to gain assessable income”.

Windeyer J emphasised:

²⁰⁰ Above note 188, section 82A (2).

²⁰¹ Please see ‘Self-education expenses’ in Sadiq K, Coleman C, Hanegbi R, Jogarajan S, Krever R, Obst W, Teoh J and Ting A, *Principles of Taxation Law*, para 12.580 – 12.690, (Sydney: Thomson Reuters, 2017), at 406 - 420.

²⁰² Above note 189.

²⁰³ Above note 188.

²⁰⁴ *FCT v Finn* (1961) 106 CLR 60.

²⁰⁵ *Ibid.*

²⁰⁶ *Ibid.*

²⁰⁷ *Ibid.*

²⁰⁸ *Id.*, at 63.

²⁰⁹ Above note 204, at 63. Please note S 51 is now rewritten into *ITAA 1997* as section 8-1.

“...a taxpayer who gains income by the exercise of his skill in some profession or calling and who incurs expenses in maintaining or increasing his learning, knowledge, experience and ability in that profession or calling necessarily incurs those expenses in carrying on his profession or calling”.²¹⁰

*FCT v Hatchett*²¹¹

*Hatchett's Case*²¹² clarified the deductibility of university course fees and the cost of the taxpayer's Teacher's Higher Certificate derived during the taxpayer's course of employment. This case was an appeal by the Federal Commissioner of Taxation against a Taxation Board of Review decision.²¹³ The judgement was delivered by Menzies J.

Hatchett was a teacher employed by the Education Department of Western Australia who paid two amounts for self-education.²¹⁴ The first payment was \$89 for gaining a Teacher's Higher Certificate. The second payment was \$90 for subjects in the faculty of arts including \$19 reimbursed by the Education Department.

In relation to expenses for the certificate, Menzies J delivered the judgment as follows:

“...the expenditure in gaining the Teacher's Higher Certificate was incurred in gaining assessable income in the circumstances carries with it the conclusion that the expenditure was not of a private nature. It must be a rare case where an outgoing incurred in gaining assessable income is also an outgoing of a private nature”.²¹⁵

In relation to expenses for the university fees, Menzies J delivered the judgment as follows:

“...The university fees paid were paid with the encouragement of the department; it contributed towards them. This, however, is not, of itself, enough to bring the fees within s. 51. Enlightened employers often encourage employees to improve their bodies and their minds, and assist them to do so. Such encouragement is not, of itself, enough to warrant the deduction of outgoings for these purposes”.²¹⁶

His Honour emphasised:

“...this general consideration is not enough to make the fees deductible; there must be a perceived connexion between the outgoing and assessable income”.²¹⁷

A significance of *Hatchett's Case*²¹⁸ is that an expenditure incurred for work related purposes is perceived to be not of a “private” purpose, establishing certainty when a taxpayer gains academic and vocational qualifications during the course of employment.

²¹⁰ Above note 204, at 70.

²¹¹ *FCT v Hatchett*, (1971) 125 CLR 494.

²¹² *Ibid.*

²¹³ *Ibid.*

²¹⁴ *Ibid.*

²¹⁵ *Id.*, at 498.

²¹⁶ *Id.*, at 499.

²¹⁷ *Id.*, at 499.

²¹⁸ Above note 211.

*FCT v Studdert*²¹⁹

The decision in *Studdert's Case*²²⁰ allowed deduction of expenditure incurred on additional vocational qualification that improved the taxpayer's skills as a flight engineer. This case was an appeal by the Federal Commissioner of Taxation against a decision of the Administrative Appeals Tribunal. The judgement was delivered by Hill J.

Studdert was a flight engineer employed by Qantas Airways Ltd who paid \$7240 for flying lessons. Hill J held that the payment of \$7240 had the necessary connection with the production of his assessable income, thus the taxpayer was allowed to claim a deduction of \$7240.²²¹

In terms of the “necessary connection”, His Honour emphasised:

“where an outgoing is shown to contribute or to likely to contribute to increased income, it will normally be the case that the necessary connection will exist between the outgoing and the activities of the taxpayer which more directly contribute to the gaining or production of assessable income”.²²²

5.3 Conclusion and Remarks

This section demonstrated taxpayers' confusion when claiming the Continuing Education Deduction through the Electronic Tax Bureau. The reason behind their confusion is the lack of policy detail. The Continuing Education Deduction policy is uncertain for taxpayers who gain vocational qualification continuing education.

Australia's work-related self-education deduction policy is an example of policy certainty that may inform China's further reform on its Continuing Education Deduction policy. The *ITAA 1936*²²³ and *ITAA 1997*²²⁴ provide clear definitions of key concepts and cite specific sections from other statutes (such as the *Higher Education Support Act 2003*²²⁵) to avoid confusion. Decisions from judges in case law bring compliance certainty to these details. China is a civil law country, so there is no case law. To improve policy certainty, China can learn from Australia's practices in the *ITAA 1936*²²⁶ and *ITAA 1997*,²²⁷ such as referring to statutes for definitions. In the PRC, taxpayers can find definitions and details of academic qualification (degree) in the *Higher Education Law*,²²⁸ but currently the *Vocational Education Law*²²⁹ does not even include definitions.

²¹⁹ *FCT v Studdert* (1991) 22 ATR 762.

²²⁰ *Ibid.*

²²¹ *Ibid.*

²²² *Id.*, at 770.

²²³ Above note 188.

²²⁴ Above note 189.

²²⁵ Higher Education Support Act 2003.

²²⁶ Above note 188.

²²⁷ Above note 189.

²²⁸ 《中华人民共和国高等教育法》 *Law of the People's Republic of China on Higher Education* 2018 (Standing Committee of the National People's Congress).

²²⁹ 《中华人民共和国职业教育法》 *Vocational Education Law of the People's Republic of China* 1996 (Standing Committee of the National People's Congress).

On 24th January 2019, the PRC's State Council issued the Notice on the Implementation of the National Vocational Education Reform Plan (Vocational Education Reform Plan).²³⁰ The Vocational Education Reform Plan²³¹ highlighted that there are some problems with China's vocational education system, especially the vocational education framework and standards. This reform aims to clarify types of vocational education and standards of vocation qualification in the PRC. The State Council stated the whole reform will last five to ten years.

On 5th December 2019, the PRC's Ministry of Education issued the revised draft of the *Vocational Education Law*.²³² Article 2 does include a definition, but it does not have enough certainty for the purpose of tax compliance, where taxpayers have to claim the Continuing Education Deduction through the Electronic Tax Bureau.²³³

VI. Conclusion

This article filled the first gap in the current literature. It examined the effectiveness of the Continuing Education Deduction policy by adopting Adam Smith's four principles of good tax design. Firstly, the authors of this article examined the policy effectiveness of the Continuing Education Deduction according to Adam Smith's good tax design principles, particularly focusing on 'convenience', 'economy' and 'equality'. According to the microeconomic quantitative analysis, the Continuing Education Deduction policy satisfies these three principles.

The authors then focused on the implementation of the 'certainty' principle in identifying the challenge of China's Continuing Education Deduction policy. After performing a case study, it concluded that the lack of compliance 'certainty' is the reason behind taxpayers' confusion when claiming the Continuing Education Deduction. It used Australia's work-related self-education deduction policy as an example of policy 'certainty' and suggested future regulators in China draw on lessons from Australian experiences to further reform China's Continuing Education Deduction policy.

In conclusion, the authors contend that China's Continuing Education Deduction policy is good tax design in general, but it is still subject to a further improvement, such as 'certainty' issues. It contents that China can arguably learn from Australia's practices in the *Income Tax Assessment Act 1936*²³⁴ and the *Income Tax Assessment Act 1997*,²³⁵ and improve the 'certainty' of its Continuing Education Deduction policy by referring policy details to other statutes.

²³⁰ 《国家职业教育改革实施方案》 *Notice on the Implementation of the National Vocational Education Reform Plan 2019* (State Council).

²³¹ *Ibid.*

²³² 《教育部关于〈中华人民共和国职业教育法修订草案（征求意见稿）〉公开征求意见的公告》 *Vocational Education Law of the People's Republic of China Draft for Public Consultation 2020* (Ministry of Education).

²³³ *Id.*, Art 2.

²³⁴ *Income Tax Assessment Act 1936*.

²³⁵ *Income Tax Assessment Act 1997*.

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A Review of China Approach to Cooperative Compliance in Light of the International Tax Practice and the OECD Framework

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Abstract: Cooperative tax compliance approaches were initiated in the 2000s with the intention to allocate tax administrations' limited resources in a more effective manner, i.e. focusing tax supervision at high-risk taxpayers while establishing a more collaborative, transparent, and trust-based relationship with low-risk taxpayers. On the other hand, taxpayers expected to gain earlier tax assurance and lower tax compliance burden. This article investigates cooperative compliance approaches identified in China, especially the 'Tax Compliance Agreement' and the 'thousand companies group', making a comparative review of such Chinese approaches to cooperative compliance, the pillars described by the OECD and cooperative compliance programs of some pioneer countries.

Keywords: tax compliance agreement; cooperative compliance; tax control framework; responsive regulation

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I. Object of Research

In the 2019 Tax Administrations Series, the Chinese tax administration reported that a cooperative compliance approach was being implemented in 2016 and 2017, with the participation of 1,062 businesses.^{1,2}

This article investigated the Chinese approach to cooperative tax compliance, how it has developed and compared it with the international experience.

Whether the Chinese experience can be understood as Cooperative Compliance is determined, for the purposes of this investigation, based on a paradigm concept derived from the OECD 2008³ and 2013⁴ cooperative compliance framework, alongside specific elements and mechanisms of cooperative compliance identified in the international tax practice.

The following research question, and two sub-questions, were addressed: What are the characteristics and elements of the Chinese approach to Cooperative Compliance? Which are the characteristics and elements of Cooperative Compliance laid down by the OECD and/or identified in the international tax practice? Does the Chinese approach fall within the scope of Cooperative Compliance as understood by the OECD and international tax practice?

It is not the main object of the present study to assess the actual realisation and fulfillment of the investigated elements of Cooperative Compliance in China, but instead to verify whether the Chinese regulatory framework provides for the elements and mechanisms expected from a Cooperative Compliance approach.

II. The Development of Cooperative Compliance

Tax compliance regulatory frameworks have traditionally been based on ‘punishment and control’ approaches, meaning that tax regulations have been designed to instil fear in taxpayers and, by threatening with heavy penalties, to discourage non-compliant behaviours. That rationale derives from Becker’s⁵ theory of crime, according to which criminals take into consideration an economic risk-reward analysis to decide whether a crime is worth to be committed. The higher the risks or the costs of being caught, the lower the incentive to commit a crime. That

¹ OECD-FTA, ‘Tax Administration 2019: Comparative Information on OECD and other Advanced and Emerging Economies’, *OECD Publishing*, 2019 <<https://doi.org/10.1787/74d162b6-en>> (4 November 2020), annex A, table A-151.

² The following questionnaire published by the OECD-FTA in 2021, regarding years 2018 and 2019, has a different structure. It does not inform anymore about countries with an ‘implementing’ status, nor about the number of companies joining the cooperative compliance approaches. China informed that a cooperative compliance approach existed in 2018 and 2019. See: OECD-FTA, ‘Tax Administration 2021: Comparative Information on OECD and other Advanced and Emerging Economies’, *OECD Publishing*, 2021 <<https://doi.org/10.1787/cef472b9-en>> (22 September 2021), p. 342.

³ OECD, ‘Study into the Role of Tax Intermediaries’, *OECD*, 2008 <<http://www.oecd.org/tax/administration/39882938.pdf>> (11 Apr. 2019).

⁴ OECD, ‘Co-operative Compliance: A Framework: From Enhanced Relationship to Co-operative Compliance’, *OECD Publishing*, 2013 <<https://dx.doi.org/10.1787/9789264200852-en>> (11 Apr. 2019).

⁵ Becker, G. S., ‘Crime and Punishment: An Economic Approach’, *Journal of Political Economy*, 1968 <<https://doi.org/10.1086/259394>> (20 November 2019), 169-217.

same rationale has traditionally been used to design the regulatory tax compliance framework of many countries.^{6,7}

Over time, legislators and tax regulators realised that such approach is not always effective to achieve tax compliance.

... a robust body of literature, produced mainly as of the late 1980s, brought up assorted theoretical arguments and empirical evidence demonstrating that there are many other factors besides a mere cost-benefit (or risk-reward) analysis which influence taxpayers' decisions on whether or not to pay taxes.

To begin with, Smith & Kinsey noted that some non-compliance is actually unintentional, and therefore unlikely to be affected by deterrence mechanisms. Alm, McClelland & Schulze found empirical evidence demonstrating that, different from what common sense might suggest, most individuals actually pay taxes even when it is unlikely that they will be caught and penalised. Cowell & Gordon, Levi and Moore suggested that taxpayers are more willing to pay taxes when they perceive that the Government will provide benefits corresponding to the taxes paid (fiscal exchange theory). Frey proposed the existence of intrinsic motivations to pay taxes, known as tax morale. According to Snavelly, tax behaviour is influenced by the social norms of the group of which the taxpayers are part, i.e., individuals adopt behaviours corresponding with how they believe others from their group will behave (social influence theory). Feld & Frey proposed a psychological contract theory, according to which individuals pay taxes in proportion to their ability to participate in the government: the more directly they participate, the more taxes they are prepared to pay. Wenzel suggested that taxpayers are also influenced by factors such as (their own) reputation, justice and fairness. McKerchar & Evans identified the main motivation to pay taxes in the ideas of justice and equitable treatment (equity theory).

The slippery-slope theory, proposed by Kirchler, Hoelzl & Wahl, integrated the intrinsic and extrinsic motivators to pay taxes. The extrinsic motivator is the individuals' perception of the authority's power (potential to detect and punish tax evasion). The intrinsic motivator derives from the trust in authorities, belief in authorities' benevolence, services and engagement. The main point is that taxpayer perception of the power of the tax authorities and taxpayer trust in the tax authorities can achieve the same level of tax compliance, but there is an optimal equilibrium to be achieved between power and trust.⁸

Australia, Ireland, the Netherlands, South Africa, the United Kingdom and the United States were pioneer countries to test alternative approaches in the design of tax compliance regulatory frameworks. Targeting taxpayers considered to be low-risk, a relationship based on trust, cooperation and transparency has been proposed, with the intention to more efficiently allocate the limited resources of tax administrations to high-risk taxpayers. As such, punishment and control should continue to exist, but restricted to non-cooperative or high-risk taxpayers.

In 2008⁹ the OECD summarised some characteristics of such 'enhanced relationship' approaches adopted in Ireland, the Netherlands and the USA, and proposed some specific behaviours which, if adopted by taxpayers and tax administrations, were

⁶ Allingham, M. G., & Sandmo, A., 'Income Tax Evasion: A Theoretical Analysis', *Journal of Public Economics*, 1972, 1(3-4), 323-338.

⁷ Srinivasan, T. N., 'Tax Evasion: A Model', *Journal of Public Economics*, 1973, 2(4), 339-346.

⁸ Martini, M. H., 'An Investigation of Co-operative Compliance Regimes and the ICAP', in Ronald Russo & Ronald Hein (Ed.), *Co-operative Compliance and the OECD's International Compliance Assurance Programme*, Alphen aan den Rijn: Kluwer Law International B.V., 2020, v. 68, pp. 1-14.

⁹ Above note 3, pp. 39-46; 77-88.

expected to create an environment where trust and collaboration would prevail.¹⁰ Those behaviours are, for tax administrations, commercial awareness¹¹, impartiality¹², proportionality¹³, openness¹⁴, through disclosure and transparency, and responsiveness¹⁵. For taxpayers, openness, through disclosure and transparency.

In 2013¹⁶, the OECD reviewed the experience of 26¹⁷ countries with Cooperative Compliance, reinforcing the five behaviours identified in the 2008 study and stressing the importance of a tax control framework as a fundamental part of the internal control framework of enterprises.¹⁸ In addition, also the need for internal mechanisms within the tax administrations were stressed, to mitigate risks of misconducts stimulated by a long-term and close relationship between tax inspectors and taxpayers.¹⁹

Despite the OECD pillars²⁰, there are many other features which are not always considered by countries which claim to have a Cooperative Compliance approach in place.

The table below shows that some essential elements of cooperative compliance, such as the existence of a tax control framework, the possibility to disclose and solve relevant tax issues on a real time basis, are not present in a large number of countries that affirm to have a cooperative compliance approach.

In around half of the countries which responded the OECD (2019) questionnaire²¹, cooperative compliance approaches did not require a Tax Control Framework to be in place. In around one third of the countries, it is not possible to discuss on a real-time basis with tax inspectors nor it is possible to solve tax issues on real-time.

Table 1: Features of Cooperative Tax Compliance as per the 2019 OECD questionnaire

Year	N° of countries		N° of Countries where Cooperative Tax Compliance Programmes entail:			
	that responded to the questionnaires	with Cooperative Tax Compliance: planning, implementing or in place	the need to have a TCF as a requirement to join	disclosure of relevant tax issues on a real-time basis	real-time solving of relevant tax issues	pending tax issues to be resolved
2014	55	33	14	24	22	12
2015	55	33	14	25	21	12
2016	58	35	18	26	25	16
2017	58	37	18	26	25	16

Source: table reproduced, without modification, from: Martini, Russo & Pankov (2021)²².

¹⁰ Above note 3, p. 40.

¹¹ Above note 3, pp. 34-35.

¹² Above note 3, pp. 73-76.

¹³ Above note 3, pp. 35-36.

¹⁴ Above note 3, pp. 36-37.

¹⁵ Above note 3, p. 37.

¹⁶ Above note 4.

¹⁷ Above note 4, p. 17.

¹⁸ Above note 4, pp. 57-59.

¹⁹ Above note 4, pp. 65, 66.

²⁰ Commercial awareness, impartiality, proportionality, openness through disclosure and transparency, responsiveness, trust, cooperation, risk assessment of taxpayers, tax administration internal governance to prevent misconducts deriving from cooperative compliance and tax control framework.

²¹ Above note 1.

²² Martini, M. H., Russo, R., & Pankov, Y., 'An Analysis of the Russian Tax Monitoring Programme in Light of the OECD Concept of Cooperative Tax Compliance and the Experience of Other Countries', *European Taxation*, 2021, 61(1), 29-40, <https://research.ibfd.org/#/doc?url=/document/et_2021_01_ru_1 (18 May 2021), p. 30.

Such inconsistency, on how to determine whether a country has an approach which can be called Cooperative Compliance, can be problematic, such as discussed below:

There are many features and mechanisms that may differ from country to country in respect of approaches to Cooperative Tax Compliance, such as: the existence of a formal instrument between taxpayers and the tax administration; the need to liquidate past tax debts as a requirement to join a cooperative compliance programme; an obligation to implement a tax control framework (TCF); standards or requirements of the TCF; the regulatory framework for Cooperative Tax Compliance, in terms of whether it is laid down in a regulation and whether such a regulation is a hard or soft law; access to the tax authorities; whether real-time solutions are available in respect of tax disputes; the possibility to litigate tax issues while a party to Cooperative Tax Compliance, among others. ...

Because there are so many features to choose from, the concrete approaches to Cooperative Tax Compliance adopted by different countries may be quite different from one another. Nevertheless, the same terminology, i.e., Cooperative Compliance, is used to refer to any and all approaches that promote interaction between taxpayers and tax administration, regardless of any differences in approach. This creates significant difficulties, as “apples and oranges” are being referred to with the same terminology, potentially causing scientific debate to be flawed due to misconceptions in terminology.²³

Therefore, in order to assess whether the Chinese approach can be regarded as Cooperative Compliance, this investigation takes into consideration the following additional features: tax control framework, regulatory framework, possibility to engage in real-time discussions with tax authorities, possibility to agree-to-disagree and the requirement to clear the past before joining.²⁴

If an effective tax control framework is in place, it is expected that the information provided by the taxpayer will be free from material misstatements and, as such, that the tax authority has elements to trust the taxpayers, i.e., ‘justified trust’.

The regulatory framework should provide the tax authority with enough tools to enforce measures that are proportional to the taxpayer’s behaviour, escalating to more severe punishments only if needed and to adopt less intense supervision as the case may be.

Of absolute importance is the concrete possibility of real time conversations between taxpayers and the tax authority, so that tax issues can be solved immediately, if possible, even before the tax return is filled and, in any case, before court litigation is started. But, if the parties cannot settle a dispute between themselves and consequently if court litigation needs to be started, that should not be a reason to hinder or to stop the cooperative compliance relationship, as the parties should beforehand recognise each other’s right to ‘agree to disagree’.

Ideally, past tax debts and disputes should be settled to ensure a stronger trust-based relationship between taxpayers and the tax authority. Nonetheless, if that is not possible, the ‘agree to disagree’ adage should be enough to allow the cooperative relationship to exist anyway.

²³ Above note 22, p. 1.

²⁴ Above note 22.

III. Tax environment and accounting developments in China

The development of the Chinese tax system is closely related with the transition, started in 1978, from the Chinese ‘planned economy’ to a so called ‘socialist market economy’. Enterprises, which not long ago were all owned by the Chinese Government, now could be privately-owned. That, of course, affected the Government’s financing which gradually shifted from proceeds generated by the state owned enterprises, to receipts generated by taxes.²⁵

In 2011, state owned enterprises (SOE) accounted for around 35% of the total Chinese companies.²⁶ In 2017, they contributed to between 23% and 28% of the Chinese gross domestic product (GDP).²⁷

Looking at the largest Chinese companies, the participation of the Government is significantly more relevant. In 2019, 60% of the top 300 Chinese companies, in terms of stocks traded on the Shanghai Stock Exchange (CSI 300), were state-owned.²⁸ In another index, the 2020 Fortune Global 500²⁹, from the 124 Chinese companies listed among the top 500, 91 (or 73%) were state owned.³⁰ Those numbers evidence that despite the overall increase in the number of privately owned companies, a relevant portion of the largest ones continue to be state-owned.

Despite the transition in the direction of a market economy, intense influence of the Government in private companies continues to exist nowadays at very significant level, what is illustrated by recent episodes such as the placement of government officials to work inside 100 private companies³¹, or the sudden tightening of regulatory environment for big tech companies in response to criticisms made against the Chinese government³².

²⁵ Zhang, T., Turley, C., & Wei, F., ‘China (People’s Rep.) - Tax Risk Management’, *Country Tax Guides*, IBFD, 2020 <https://research.ibfd.org/#/doc?url=/document/rmtp_cn_s_2.> (1 June 2021), section 1.1..

²⁶ The New York Times, ‘China’s Grip on Economy Will Test New Leaders’, 2012, online <<https://www.nytimes.com.tilburguniversity.idm.oclc.org/2012/11/10/world/asia/state-enterprises-pose-test-for-chinas-new-leaders.html>> (6 October 2021).

²⁷ Zhang, C., ‘How Much Do State-Owned Enterprises Contribute to China’s GDP and Employment?’, Washington DC: World Bank, 2019 <<https://openknowledge.worldbank.org/handle/10986/32306>> (2 August 2021).

²⁸ Hissey, I., ‘Investing in Chinese State-Owned Enterprises’, *Factset*, 2019, online <<https://insight.factset.com/investing-in-chinese-state-owned-enterprises>> (2 August 2021).

²⁹ Fortune, ‘Global 500’, 2021, online <<https://fortune.com/global500/2021/search/>> (2 August 2021).

³⁰ Kennedy, S., ‘The Biggest But Not the Strongest: China’s Place’, *Fortune Global 500*, Center for Strategic & International Studies, 2020, online <<https://www.csis.org/blogs/trustee-china-hand/biggest-not-strongest-chinas-place-fortune-global-500>> (2 August 2021).

³¹ Taylor, C., ‘China to place government officials inside 100 private companies, including Alibaba’, *CNBC*, 2019 <<https://www.cnbc.com/2019/09/23/china-to-place-government-officials-in-100-companies-including-alibaba.html>> (24 September 2021).

Financial Times, ‘China government assigns officials to companies including Alibaba’, 2019, online <<https://www.ft.com/content/055a1864-ddd3-11e9-b112-9624ec9edc59>> (24 September 2021).

³² Chau, D., ‘China’s crackdown on ‘powerful’ tech giants may be a ‘terrible own goal’’, *ABC*, 2021 <<https://www.abc.net.au/news/2021-08-19/china-tech-crackdown-alibaba-jack-ma-risky-investment/100387392>> (24 September 2021).

Bloomberg, ‘The China Model: What the Country’s Tech Crackdown Is Really About’, online <<https://www.bloomberg.com/news/articles/2021-07-27/china-tech-crackdown-xi-charts-new-model-after-emulating-silicon-valley>> (24 September 2021).

The overlapping of Government and state-owned enterprises' interests has been investigated by the literature, which suggests that state-owned companies may be used to implement social policies in China, in prejudice to their profits:

In China, SOEs are likely to incur significant agency costs when state shareholders (i.e., the government or politicians) tend to maximise social or political benefits instead of maximising corporate profits (e.g., Fan et al., 2007). **For example, China's central and local governments often request firms to absorb excess labour, sponsor public projects, and help jump-start local economies.** [emphasis added]³³

In relation with taxation, empirical findings suggest that large state-owned companies pay less taxes than their private-owned peers as a result of the political power of the first.³⁴ On the other hand, smaller state-owned companies, which lack the same political influence, tend to pay more taxes than the comparable private-owned enterprises.³⁵ A third study indicates that state-owned companies are associated with less tax planning where the State has a direct benefit from higher tax payments.³⁶ Those investigations evidence that the fact that a company is state-owned has an influence on their tax compliance behaviour, in comparison with private-owned companies.

A possible speculation could be that the still intense participation of the Chinese Government in the enterprises, either through direct or indirect investment, or through the presence of government officials in the administration of the companies, may induce a cooperative relation between enterprises and the tax administration.³⁷

Some examples of the cooperative tax compliance environment in China are:

- first offence should attract no penalty, according to the recent official position from tax administration;³⁸
- taxpayers have the opportunity to amend their tax returns;
- mandatory “self-inspection” and “self-audits” by the enterprises;
- tax inspectors apply a ‘tax-payer specific’ interpretation of the law (private letter rulings).

Tax litigation, either administrative or judicial, is not the preferred alternative where taxpayers disagree with the outcome of a tax audit procedure. Instead, the

³³ Lin, K. J., Lu, X., Zhang, J., & Zheng, Y., ‘State-owned enterprises in China: A review of 40 years of research and practice’, *China Journal of Accounting Research*, 2020, 13(1), 31-55 <<http://dx.doi.org/10.1016/j.cjar.2019.12.001>> (6 October 2021), p. 43.

³⁴ Wu, L., Wang, Y., Gillis, P., & Luo, W., ‘State ownership, tax status and size effect of effective tax rate in China’, *Accounting and Business Research*, 2012, 42(2) <<http://dx.doi.org/10.1080/00014788.2012.628208>> (6 October 2021).

³⁵ Above note 34.

³⁶ Eberhartinger, E., & Samuel, D. M. (2021). Monitoring and Tax Planning – Evidence from State-Owned Enterprises. (E. Eberhartinger, E. Kirchler, M. Lang, R. Sausgruber, & M. Zagler, Eds.) *WU International Taxation Research Paper Series*, <<https://ssrn.com/abstract=3632938>> (6 October 2021).

³⁷ “One important point to note is that, unlike tax audits in many other countries which often are adversarial proceedings, taxpayers involved in an audit in China should try to cooperate with the tax authorities as much as possible. An uncooperative attitude is likely to antagonize local officials, leading to a less satisfactory result.”, see above note 25, section 4.3.2.

³⁸ China International Fair for Trade in Services, ‘China will introduce “No Penalty for First Violation” tax regulation list to improve enforcement fairness and efficiency’, 2021, online <<https://cms.ciftis.org/article/8854781286412288.html>> (6 October 2021).

historically adopted option has been to engage in direct communication and negotiation with the responsible tax authorities.³⁹

In relation with the accounting framework, the re-opening of the Stock Exchanges, Shanghai⁴⁰ and Shenzhen⁴¹ both in 1990, is the milestone which led Chinese accounting regulations to be harmonised with international financial reporting standards (IFRS):⁴²

- 1992, with the Enterprise Basic Accounting Standards (EBAS);
- 1998, with the Accounting System for Joint Stock Limited Enterprises (ASJSLE);
- 2001, with the Accounting System for Business Enterprises (2001 Accounting System), which replaced the ASJSLE, and;
- 2006 with the new China Accounting Standards (CAS), mandatory to all listed companies as of 2007.

Empirical evidence suggests that the 2006 China Accounting Standards improved the quality of reporting, lowered cost of capital, led to more attractiveness to foreign investments and improved corporate governance, from an auditors' perspective.⁴³

Following the harmonisation with the IFRS, in 2008 the Basic Standards for Enterprise Internal Control (BSEIC)⁴⁴ were introduced. It adopted the 1992⁴⁵ and 2004⁴⁶ COSO frameworks and required, for example, all listed companies to publish the auditors' opinion on the effectiveness of the internal control systems.^{47, 48} In 2010, three Guidelines on the application, evaluation and auditing of the Basic Standards for Enterprise Internal Controls were issued.⁴⁹

³⁹ Wen, J., 'Handling Tax Disputes in Asia Pacific', *Baker McKenzie*, 2020, online <<https://resourcehub.bakermckenzie.com/en/resources/-/media/cd1d2d7cbeef4ac2aa80363666d095d4.ashx>> (21 June 2021), p. 49-51.

⁴⁰ Shanghai Stock Exchange, 'Historical Events', online <<http://english2019.sse.com.cn/aboutsse/sseoverview/historical/>> (21 June 2021).

⁴¹ Shenzhen Stock Exchange, 'Milestones', online <<http://www.szse.cn/English/about/milestones/index.html>> (21 June 2021).

⁴² Cai, M., Chen, T. T., & Zhou, G., 'Progress of and Obstacles to IFRS Implementation in an Emerging Economy: Auditors' Perspective', *China Accounting and Finance Review*, 2020, 22(1) <https://www.researchgate.net/publication/341165929_Progress_of_and_Obstacles_to_IFRS_Implementation_in_an_Emerging_Economy_Auditors'_Perspective#fullTextFileContent> (10 June 2021).

⁴³ Above note 42.

⁴⁴ Basic Standards for Enterprise Internal Control (2008), online <http://www.mof.gov.cn/gkml/caizhengwengao/caizhengbuwengao2008/caizhengbuwengao20087/200810/t20081030_86252.htm> (10 June 2021).

⁴⁵ Committee of Sponsoring Organizations of the Treadway Commission (COSO), 'Internal Control-Integrated Framework', 1992, online <<https://www.coso.org/pages/ic.aspx>> (16 June 2021).

⁴⁶ Committee of Sponsoring Organizations of the Treadway Commission (COSO), 'Enterprise Risk Management - Integrated Framework, Executive Summary', 2004, online <<https://www.coso.org/Documents/COSO-ERM-Executive-Summary.pdf>> (16 June 2021).

⁴⁷ Above note 42.

⁴⁸ Empirical evidence suggests that COSO-based internal controls in China have the potential to curb tax avoidance for over-sheltered firms and, on the other hand, to increase tax avoidance for under-sheltered firms, see: Chen, H., Yang, D., Zhang, X., & Zhou, N., 'The Moderating Role of Internal Control in Tax Avoidance: Evidence from a COSO-Based Internal Control Index in China', *The Journal of the American Taxation Association*, 2020, 42(1), 23-55 <<https://aaajournals.org/doi/10.2308/atax-52408>> (5 May 2021).

⁴⁹ China, Ministry of Finance, 'Guidelines for the application, evaluation and auditing of Enterprise Internal Controls', 2010, online <<http://www.lawinfochina.com/display.aspx?lib=law&id=9078&CGid=>> (5 May 2021).

Between 2006 and 2013 accounting and auditing regulations developed side-by-side, creating the regulatory framework needed for a cooperative compliance approach to emerge in China.

A relevant development in the Chinese tax system took place in 2007, when the 'new enterprise tax law' was approved granting equal tax treatment to foreign-owned enterprises and domestic enterprises, what significantly increased the tax burden for foreign-owned enterprises as a result of the termination of tax incentives and preferential tax rates.⁵⁰

A special department within the Tax Administration, the State Administration Taxation (SAT)⁵¹, dedicated to large enterprises, was created in 2008, the Large Enterprise Tax Department (LETD). Its main role is to assess tax risks and support selected large enterprises. Over time, the LETD functions were broadened. Currently it can, for example, issue tax rulings, engage in transfer pricing audits, determine which large enterprises must self-assess their tax control framework, and lead the conclusion of tax compliance agreements.⁵²

Soon after the creation of the LETD, detailed guidelines⁵³ were issued by the SAT orientating Large Businesses on the implementation of a system to manage their tax risks, i.e., a tax control framework. Those 2009 SAT guidelines followed closely the 2004 COSO Enterprise Risk Management⁵⁴ framework, establishing corresponding objectives⁵⁵ and components⁵⁶. Tax authorities shall use those guidelines to evaluate the effectiveness of the tax control framework, and to determine further tax risk management measures. Two examples of how aligned the guidelines are with COSO recommendations are: i) the guidelines explicitly make the board of directors responsible for the supervision of the tax risk management; ii) the tax department must periodically evaluate and review the effectiveness of the tax control framework, and continuously improve and optimise it.

⁵⁰ Eichelberger, J., & Kelly, B., 'Tax Planning Strategies in Response to China's Changing Tax Landscape – Issues and Structures To Be Considered in a Post Tax Unification China', *Asia-Pacific Tax Bulletin*, 2007, 140-154.

⁵¹ Currently named the State Taxation Administration, STA, the author opted to use State Administration of Taxation, or SAT, throughout the text.

⁵² Chinese Government, General Office of the State Council, 'Provisions on the Main Responsibilities of the State Administration of Taxation, Internal Institutions and Staffing' (Guobanfa) 2008 n. 87, online <<http://www.amonijiaju.com/0y138y/article/96/130867.html>> (25 June 2021).

⁵³ Chinese Government, State Administration of Taxation, Circular (Guo Shui Fa) 2009 n. 90, *Guidelines on Tax Risk Management of Large Enterprises* (trial), <<https://www.waizi.org.cn/shuishounews/6086.html>> (16 June 2021).

⁵⁴ Committee of Sponsoring Organizations of the Treadway Commission (COSO), 2004, *Enterprise Risk Management - Integrated Framework, Executive Summary*, <<https://www.coso.org/Documents/COSO-ERM-Executive-Summary.pdf>> (16 June 2021).

⁵⁵ The following correspondence between COSO (2004), above note 54, and the SAT (2009), above note 53, can be identified: Strategic objectives: tax planning must have a reasonable commercial purpose; Operations objectives: business decision-making and daily business activities take into account the impact of tax factors; Reporting objectives: the accounting treatment of tax matters in compliance with the law and regulations; Compliance objectives: all tax compliance obligations must follow the law and regulations.

⁵⁶ The following components of the tax control framework are provided for in the SAT (2009), above note 53: business specific conditions; tax risk characteristics and existing internal risk control systems; organization, positions and responsibilities; tax risk identification and assessment mechanisms and methods; tax risk control and response mechanisms and measures; tax information management systems and communication mechanisms; tax risk management supervision and improvement mechanisms.

In 2011 the possibility of Tax Compliance Agreements (TCA)⁵⁷ was introduced. It must be signed between the SAT and large enterprises in a framework which, at least from a formal perspective, incorporated many elements of Cooperative Compliance such as laid down in the 2008 and 2013 OECD publications (see section 2).

The TCA is a voluntary agreement, based on the principles of equality, openness and mutual trust, where both parties will cooperate to prevent and control tax risks.⁵⁸ In order to be admitted, enterprises must be compliant with regulations and must have in place a tax control framework.⁵⁹

Besides the introduction of the Tax Compliance Agreement, Circular n. 71 (2011) emphasised the service-based function of the SAT, which “shall be guided by the needs of taxpayers, provide targeted taxation services, and be risk-oriented... [free translation]”.⁶⁰ The Circular provided that tax administrations, from all levels, should adopt a collaborative and transparent approach in the relationship with large enterprises, including the following functions:

- Guidance on how to improve the handle of tax related affairs;⁶¹
- To solicit and collect opinions from enterprises regarding the improvement of taxation policies and management systems;⁶²
- To disclose the taxation policy and management systems used by tax administration;⁶³
- To promptly accept and respond to tax-related claims;⁶⁴
- To promote and to guide the implementation of internal control systems for tax risks;⁶⁵
- To assess the quality of internal control systems for tax risks and to suggest improvements;⁶⁶
- To take into account specific businesses segments and processes;⁶⁷
- To use computer-based risks identification;⁶⁸
- Tax monitoring targeted on the taxpayer’s risk profile;⁶⁹
- To provide feedback to enterprises regarding their tax compliance status, by means of a compliance report;⁷⁰
- To ensure qualification and commercial awareness of tax inspectors.⁷¹

⁵⁷ Chinese Government, State Administration of Taxation, Circular (Guo Shui Fa) 2011 n. 71, *Regulations on Taxation Services and Management of Large Enterprises* (trial), <<https://www.waizi.org.cn/shuishounews/6088.html>> (16 June 2021), section 4, articles 17-21.

⁵⁸ Above note 57, article 17.

⁵⁹ Above note 57, article 18.

⁶⁰ Above note 57, article 2.

⁶¹ Above note 57, article 4.

⁶² Above note 57, articles 5, 7.

⁶³ Above note 57, article 6.

⁶⁴ Above note 57, articles 9-12.

⁶⁵ Above note 57, articles 13, 14.

⁶⁶ Above note 57, articles 15, 16.

⁶⁷ Above note 57, article 24.

⁶⁸ Above note 57, articles 29, 30.

⁶⁹ Above note 57, articles 35-39.

⁷⁰ Above note 57, articles 44-48.

⁷¹ Above note 57, articles 57-59.

In 2013 the SAT put forward opinions intended to strengthen the service-function of the tax administration. It emphasised the tax administration's openness and collaboration in the relationship with large enterprises:⁷²

- large enterprises will have a point of contact within the SAT;
- tax authorities will set up work groups to discuss businesses, industries and organisational characteristics of the enterprises;
- listen to opinions and suggestions from enterprises, understanding the production and operation and major tax matters;
- promptly respond to tax-related claims from large enterprises;
- establish a dialogue mechanism, intended to promote cooperation and mutual trust;
- to promote the negotiation and signing of tax compliance cooperation agreements;
- to stimulate large enterprises to improve their tax risk internal control mechanisms;
- to improve working processes for advance rulings;
- to establish a reporting system for large enterprises to report their major tax issues;
- to establish guidelines for a tax control framework;
- to develop the testing of the tax control framework;
- to approximate the internal controls and the tax control framework.⁷³

The SAT strongly relies on a service-based relationship together with the risk assessment of enterprises. The SAT emphasis on the risk management of taxes was materialised in Opinion 105 issued in 2014 to address the “inconsistent understanding of tax risk management in some regions and units, inaccurate positioning, unclear responsibilities, and unsound mechanisms [free translation]”.⁷⁴ Noteworthy that Opinion 105 dealt with ‘tax risk management’ from the perspective of the tax administrations, defining it as:

[...] the use of risk management theories and methods by tax authorities to rationally allocate tax management resources based on a comprehensive analysis of the taxpayer's tax law compliance status. Through risk warning, tax assessment, tax audit, anti-tax avoidance investigation, tax audit and other risk response methods, we can prevent and control tax risks, improve taxpayers' compliance with tax laws, and improve tax management activities by tax authorities. [free translation].⁷⁵

The SAT strategy is to look at the taxpayers' tax risk management, more specifically at the risks which were mapped or identified by the taxpayers and, based on that, determine how to allocate the tax administration's resources to supervise taxpayers.

On 24-12-2015 the ‘General Office of the Central Committee of the Communist Party’ and the ‘General Office of the State Council’ issued the “Deepening the

⁷² Chinese Government, State Administration of Taxation, Opinion (Shui Zongfa) 2013 n. 145, *Opinions on further strengthening the work of individualized taxation services for large enterprises*, <<https://www.waizi.org.cn/tax/35152.html>> (16 June 2021).

⁷³ Above note 72.

⁷⁴ Chinese Government, State Administration of Taxation, Opinion (Shui Zongfa) 2014 n. 105, *Opinions on Strengthening Tax Risk Management*, <<https://www.shui5.cn/article/56/77830.html>> (24 September 2021).

⁷⁵ Above note 74.

Reform of the National Taxation and Local Taxation System", to be implemented by all regions and departments, and which included, among other objectives, the following ones:

- [...] to accelerate the construction of a service-oriented tax agency [...];
- [...] to implement standardised management of taxation services, and to implement a list of enforcement powers and responsibilities, to be announced to the public [...];
- [...] for taxpayers with good tax credit, open a green channel for tax processing, provide more convenience in data submission, receipt of invoices, export tax rebates, etc., reduce the frequency of tax inspections or grant inspection exemption for a certain period of time [...]. For parties who enter the "blacklist" of taxation violations, strict taxation management, and the implementation of punishments [...] Let the honest and law-abiding people go unimpeded, and make it difficult for the untrustworthy and lawbreakers;
- [...] Companies are managed according to their scale and industry, and individuals are managed according to income and assets. In 2016, the State Administration of Taxation and provincial tax bureaus focused on industry risk analysis and risk analysis of large enterprises, high-income and high-net-worth taxpayers, and used third-party tax-related information to compare tax returns and distinguish different risk levels [...];
- Fully implement electronic invoices;
- Give full play to the role of taxation big data in serving national governance;
- Continuously strengthen international taxation cooperation. Focusing on the establishment of a new type of international taxation relationship featuring win-win cooperation, promote the improvement of international taxation cooperation and coordination mechanisms [...]. [free translation]⁷⁶

In 2015 the SAT created the ‘thousand companies group’ plan, intended to supervise the group of largest companies from diverse segments more closely.⁷⁷ Considering the annual tax payment of more than 300 million yuan together with industry segment representativity, in 2016 the ‘thousand companies group’ was comprised by 1,062 companies, which is the same number of companies which the Chinese tax administration informed to be participating in the cooperative compliance approach in 2016 and 2017, with an ‘implementing’ status, suggesting that the Chinese tax administration identifies the ‘thousand companies group’ with cooperative compliance.^{78, 79, 80}

⁷⁶ Chinese Government, ‘the Plan for Deepening the Reform of the National tax and local tax collection and management system’, 24-12-2015, online <http://www.gov.cn/xinwen/2015-12/24/content_5027603.htm> (01 October 2021).

⁷⁷ Information about the ‘thousand companies group’ plan was provided in 2016, see: Chinese Government, SAT announcement n. 67, 2016, online <<http://www.chinatax.gov.cn/chinatax/n810341/n810825/c101434/c4311563/content.html>> (24 September 2021).

⁷⁸ Wangliang, M., ‘Research on Tax Risk Management of Thousand Enterprises Group’, 20-08-2020, online <<https://www.fx361.cc/page/2020/0820/8008186.shtml>> (1 October 2021).

⁷⁹ Chinatax, ‘Shenzhen State and Land Tax: To create an "international model" tax service system for large enterprises’, 26-04-2017, online <<http://www.chinatax.gov.cn/chinatax/n810219/n810780/c2579893/content.html>> (1 October 2021).

⁸⁰ Above note 1, annex A, table A.151.

The ‘thousand companies group’ plan required the selected companies to file electronically more detailed reports, including all companies of the group, containing operational, financial, tax and accounting information.⁸¹ That wide volume of information was later restricted to “financial and accounting data (and at the “report” level, rather than transaction level)” after a meeting with the Business and Industry Advisory Committee to the OECD (BIAC).⁸² In addition, companies included in the ‘thousand group’ must also: organise and correct the information delivered, in accordance with the verification results and feedbacks provided by tax administration; to train and provide guidance to companies of the group regarding the compliance with the ‘thousand companies group’ information requirements.⁸³ Further instructions about the ‘thousand companies group’ plan were given by the SAT in an announcement issued in 2017.⁸⁴ After that announcement, the Chinese tax administration informed in the OECD-FTA Tax Administrations Series⁸⁵ to have a cooperative compliance approach in place.

The personalised services to which the ‘thousand companies’ group’ have access include: dedicated communication channels, tax policy certainty and uniformity, risks reminders, guidance on the implementation and improvement of the tax control framework, cooperative tax compliance approach.⁸⁶

A central key of the ‘thousand companies’ group’ is the focus on collection of data from different sources, including third parties, using data mining and, later, the risk assessment of the companies using ‘software screening and manual review’, in a coordinated work carried out by the central tax administration together with the provincial level tax administration.⁸⁷ Big data analysis is used for the risk assessment of the taxpayers, for the audit targeting and to improve audits performance.^{88, 89}

Some criticisms have been made to the ‘thousand companies’ group’ plan:

- The method to audit the ‘thousand companies’ group’ in relation with their tax risks is very different from traditional auditing methods. The tax authorities use big data analysis to predict in advance the tax risks of the ‘thousand companies’ group’ and conduct targeted inspections. In addition, the ‘thousand companies’ group’ lacks a quick response mechanism. The time left for the ‘thousand companies’ group’ to deal with tax risks is greatly reduced, which can eventually expose tax control framework weaknesses;⁹⁰

⁸¹ Fukai, Wang, 2017, interview, online <<https://www.taxhu.com/index.php?m=article&f=view&id=190796>> (01 October 2021).

⁸² BIAC Meets with China’s State Administration of Taxation, 21-07-2016, online <<https://biac.org/wp-content/uploads/2016/08/BIAC-Meets-with-China-SAT-v2.pdf>> (5 October 2021).

⁸³ Chinese Government, State Administration of Taxation, announcement n. 7, 2017, online <<http://www.chinatax.gov.cn/n810341/n810765/n2511651/n2511713/c2712528/content.html>> (24 September 2021), article 13.

⁸⁴ Above note 83.

⁸⁵ Above note 2, annex A, table A.49.

⁸⁶ Above note 81.

⁸⁷ Above note 78.

⁸⁸ Above note 1, p. 55.

⁸⁹ Above note 25, section 5.1.2.

⁹⁰ Above note 78.

- The companies comprising the ‘thousand companies’ group’ have not implemented an effective or consistent tax control framework;⁹¹
- The headquarters generally have a tax control framework separated from the subsidiaries or local entities. Local entities generally have the tax control framework implemented and managed by people from financial and administrative departments, which in many cases lack the expertise of a tax professional. Further, local entities tend to manage the tax control framework with inputs from local tax regulations and local tax operations only.⁹²

A significant simplification in the tax compliance environment took place in 2018, when local tax bureaus (regions, municipalities, counties) ceased to exist, and the ‘Tax Bureau of the State Administration of Taxation’ became responsible to collect all national and local taxes.⁹³

The SAT launched in 2019, at national level, the third phase of the digital tax administration system, also referred to as the Golden Tax System, which operationalised not only the integration between local tax bureaus and the SAT, but also the sharing of information between the tax offices and other agencies such as “social insurance department, the Ministry of Land and Resources and the Ministry of Commerce”.⁹⁴ Further, the third phase of the Golden Tax System consolidated state of the art data warehousing, information pooling, big data analysis technologies which provided the SAT with unprecedented information technology resources.⁹⁵

IV. Comparison between China Cooperative Compliance approach and the paradigm concept used in the investigation

Circular n. 71 (2011)⁹⁶ explicitly provided for most of the Cooperative Compliance pillars laid down by the OECD⁹⁷ and, in many cases, presented mechanisms for their actual implementation. Although those elements may also be present in other regulations, the current analysis focused on Circular n. 71 (2011), which introduced the Tax Compliance Agreement.

The two requirements to sign a voluntary tax compliance agreement are: i) the status of the internal control system, and; ii) the ability to comply with tax laws.⁹⁸ The risk-profile of the enterprise is not a requirement to have a tax compliance agreement signed, but it is used to determine the tax monitoring strategy.⁹⁹ The payment of all previous tax debts, ‘clear the past’, is not provided as a requirement, but the existence of tax debts and tax contingencies could be interpreted as an

⁹¹ Above note 78.

⁹² Above note 78.

⁹³ Above note 25, section 2.2.

⁹⁴ Ołowska, M., Peshori, P., & Lan, S., ‘The Digitalization of Tax Administration in China (People's Rep.), India and Korea (Rep.) in the Fourth Industrial Revolution’, *Bulletin for International Taxation*, 2020, 465-480.

⁹⁵ Above note 25, section 5.1.

⁹⁶ Above note 57.

⁹⁷ Above note 3 and above note 4.

⁹⁸ Above note 57, article 18.

⁹⁹ Above note 57, articles 35-40.

inability to comply with tax laws and, in practice, could prevent a tax compliance agreement from being signed.¹⁰⁰

There is a clear concern for tax authorities to achieve commercial awareness, with a whole section of Circular n. 71 (2011) detailing how tax authorities will improve their knowledge and skills, always considering industries and regions' specificities.¹⁰¹ The monitoring function of the tax administration must take into consideration characteristics of the industry, the production and operation process of the enterprises.¹⁰²

Impartiality can be assumed from article 2,¹⁰³ as it is provided that the tax administration will be guided by the needs of taxpayers, be risk-oriented and implement scientific, efficient services.

The tax administration must collect the opinions of enterprises, in relation with the improvement of taxation policies and the tax monitoring function, and provide feedback.¹⁰⁴ Once the taxation policy and tax monitoring strategy are defined, the tax administration shall share them with the enterprises.¹⁰⁵ That is well aligned with the pillars of cooperation and openness, from the side of the tax administration.

Circular n. 71 (2011) provides that tax authorities shall 'promptly' accept tax-related claims, study and resolve major tax-related matters.¹⁰⁶ But there are no specific procedures for taxpayers to file tax claims or tax appeals within the tax compliance agreement's framework. For those purposes, taxpayers would then have to fall back to the regular tax procedural legislation. Circular (2013) n. 145, in turn, provides for the obligation of the tax administration to "[e]fficiently handle appeals and establish and improve a rapid response mechanism for tax-related appeals [free translation]".¹⁰⁷

The tax administration strongly focuses on the continuous evaluation and improvement of the internal controls¹⁰⁸ and the tax control framework¹⁰⁹ of the enterprises, which are used to determine their risk-profiles. The Tax Control Framework is assessed based on: i) the existence and operation of the internal controls; ii) the personnel organisation and responsibilities; iii) mechanisms to identify and evaluate tax risks; iv) mechanisms to control and respond to the tax risks; v) tax information management system and communication mechanism; vi) mechanisms to supervise and improve the tax control framework.¹¹⁰

Even outside a tax compliance agreement, it is the tax administration's practice to give the taxpayer the opportunity to correct mistakes, to make a self-assessment of

¹⁰⁰ Appeals at administrative or judicial levels, for example, have the payment of the discussed tax debt as a condition for admission, that may be an indication that tax authorities might also expect payment of past tax-debts in the case of tax compliance agreements, see: above note 39, p. 62.

¹⁰¹ Above note 39, articles 57-60.

¹⁰² Above note 39, article 24.

¹⁰³ Above note 39.

¹⁰⁴ Above note 39, articles 7, 8.

¹⁰⁵ Above note 39, article 6.

¹⁰⁶ Above note 39, articles 9, 12.

¹⁰⁷ Above note 72, article 2(5).

¹⁰⁸ Basic Standards for Enterprise Internal Control (2008), online

<http://www.mof.gov.cn/gkml/caizhengwengao/caizhengbuwengao2008/caizhengbuwengao20087/200810/t20081030_86252.htm> (10 June 2021).

¹⁰⁹ Above note 57, articles 14, 41, 42.

¹¹⁰ Above note 57, article 14.

its internal controls and only then, as a last resource, to apply penalties.¹¹¹ Proportionality derives from the fact that tax audits initiatives take into consideration the risk profile of the enterprises.

The table below summarises the comparison between the concept of Cooperative Compliance presented in section 2 and China Tax Compliance Agreement discussed in section 3:

Table 2 – Elements of Cooperative Tax Compliance: comparison between China Tax Compliance Agreement and the concept used in the investigation

Elements of the proposed paradigm concept of Cooperative Tax Compliance		China Tax Compliance Agreement	
		State Administration of Taxation Circular n. 71 (2011) ¹¹²	
OECD 2008 and 2013 publications (<i>supra</i> ns. 3 and 4)	commercial awareness	yes	arts. 24, 57-59
	impartiality	yes	art. 2
	proportionality	yes	-
	openness: disclosure and transparency	yes	arts. 5-7
	responsiveness	yes	arts. 9-12
	trust	yes	art. 17
	cooperation	yes	art. 17
	risk assessment of taxpayers	yes	28-33, 35-40
	tax administration internal governance to prevent misconducts deriving from CC	no	-
	TCF / Internal Controls	yes	arts. 13, 14
Elements of Cooperative Compliance from the International Tax Practice	TCF formally prescribed in regulation	yes	art. 14
	TCF mandatory to join CC	yes	art. 18
	CC provided in administrative regulation	yes	arts. 17-21
	formal instrument between the parties	yes	art. 17
	real-time consultation procedures	no	
	possibility to agree to disagree	no	
	CC Restricted to MNEs	yes	art. 3
	clear the past before joining	no	art. 18

Source: table created by the author, with adaptations from Martini, Russo & Pankov (2021), above note 22, p. 33.

The ‘thousand companies’ group’ plan, which the Chinese tax administration indicated to be a cooperative tax compliance approach under implementation¹¹³ in years 2016 and 2017, is actually a tax monitoring strategy with some relevant differences from the cooperative tax compliance approach in the shape of the 2008 and 2013 OECD publications and international practice. First, and the most relevant one to strike it out from cooperative compliance, is the fact that the ‘thousand

¹¹¹ Above note 25, section 4.3.2., and above note 39.

¹¹² Above note 57.

¹¹³ Above note 1, annex A, table A-151.

companies' group' plan is mandatory for all taxpayers that fall within the criteria¹¹⁴ established by the tax administration. In the author's opinion, the fact that participation is not voluntary hinders the cooperative compliance pillars of trust and cooperation.

Second, there is no risk assessment of the taxpayers as an entry criterion, but only later to determine a rating for the companies and, as the case may be, to choose the companies that will be audited.

Third, the prevailing incentive for large taxpayers within the 'thousand companies' group' to cooperate is the fact that they may be low-rated or pointed out as 'not a low-risk company', which is therefore a vertical relationship where the taxpayer is actually afraid of the consequences if they do not follow the tax authority's command.

There are, nonetheless, certain characteristics of the 'thousand companies' group' that can be identified with cooperative compliance. The enterprises are informed on the outcome of the tax risks analysis carried out by the tax authorities and are given the opportunity to make the necessary corrections before penalties are applied or inspections are started. That is well aligned with responsive regulations¹¹⁵ and the enforcement pyramid¹¹⁶, i.e., gradual escalation of deterrence mechanisms going from weak to strong enforcement, depending on the subject's behaviour and responses.

The tax auditing function of the tax administration is determined based on the risk profile of the taxpayers, which is desirable not only from a tax administration's perspective as resources will be channelled to higher risks taxpayer realising the principle of proportionality¹¹⁷, but also from the perspective of the principle of equality before the law¹¹⁸, as different taxpayers will be treated differently.

Taxpayers are encouraged to implement and keep an effective tax control framework in place¹¹⁹, which allows tax administration to rely on the information provided by the taxpayers and eventually to establish trust and cooperation from the side of the tax administration.

¹¹⁴ The main criteria is the total annual tax payment, and a list of the enterprises shall be published by the SAT on a regular basis, see: above note 83, articles 2, 5.

¹¹⁵ For a definition of responsive regulation see: Braithwaite, V., 'Responsive Regulation and Taxation: Introduction. Law and Policy', 2007, 29(1), 3-10 <<https://doi.org/10.1111/j.1467-9930.2007.00242.x>> (21 September 2021): "The implementation of responsive regulation in taxation means influencing the community's commitment to pay tax through respectful treatment, through attending to resistance and reforming faulty processes, through fairly directed and fully explained disapproval of non-compliant behavior, through preparedness to administer sanctions, and capacity to follow through to escalate regulatory intervention in the face of continuing non-compliance."

¹¹⁶ Ayres, I., & Braithwaite, J., 'Responsive Regulation: Transcending the Deregulation Debate', New York: Oxford University Press, Inc., 1992.

¹¹⁷ "Proportionality is about the choices revenue bodies make in allocating resources, deciding which taxpayers, which tax returns and which tax issues to prioritise and how to respond appropriately. In determining priorities, key skills include deciding what not to ask about and, when to discontinue an audit or enquiry that is unlikely to be a good use of those resources [...]. Proportionality also means that revenue bodies should ordinarily have regard to the overall revenue consequences of initiating a particular audit or other response. It therefore requires two things. First is that revenue bodies should focus their enquiries and examinations on the most significant issues presented by a tax return; and second is that significance for these purposes must be judged in context.", above note 3, pp. 35-36.

¹¹⁸ Above note 3, pp. 45-48.

¹¹⁹ Above note 3, pp. 44, 80.

V. Conclusions

The elements of Cooperative Tax Compliance identified by the OECD, and further elements extracted from the experiences of other countries, which formed the paradigm concept used in the analysis to confront the China approach to Cooperative Compliance, were listed and commented in section 2. Chinese approaches to Cooperative Compliance, the Tax Compliance Agreement and the ‘thousand companies’ group’, were presented and discussed in section 3. Finally, a comparison between the paradigm concept of cooperative tax compliance and the China Tax Compliance Agreement was carried out in section 4, indicating that most of the expected elements of Cooperative Compliance are present in China Tax Compliance Agreement. Further in section 4, the differences between cooperative tax compliance and the ‘thousand companies’ group’ were commented, concluding that it does not conform with the elements of cooperative tax compliance, which is a different understanding from what was informed by the Chinese Tax Administration at the 2021 Tax Administrations Series¹²⁰.

Although a cooperative tax compliance environment can be identified in China, empirical studies presented in section 3 suggest that a relevant incentive for such cooperation may be the political influence, and the presence, that the Government has in the enterprises, especially in the large ones.

¹²⁰ Above note 1.

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Comments from the Consulting Editor: Research on China's Current Charity Tax Policy and Directions for Improvement

Dongsheng Jin and Yuan Li[★]

On August 17, 2021, the 10th Meeting of the Financial and Economic Commission of the CPC Central Committee has investigated the concerns surrounding the promotion of common prosperity. The meeting has called for the establishment of basic institutional arrangements for the coordination of income redistribution on primary, secondary, and tertiary levels, alongside a greater focus on expanding the extent and precision of the redistribution pertaining to taxation, social security, and transfer payments; to promote social equity and justice alongside the well-rounded development of the individual, thus enabling progress to be made towards the goal of common prosperity for all. As charitable activities have been a primary component within the redistributions, questions surrounding methods to increase the extent and precision surrounding these charitable tax policies are thus very important considerations.

I. The Scope of Charity Tax Policy Objects

To understand charitable tax policies, there must be an accurate grasp of the premise and scope of its policy objects. Generally, charity is simply conceptualised as acts of interpersonal compassion, love, and reciprocal aid – as displayed through all manners of charitable events. From a legal perspective, it is only when the scope of what constitutes charitable events are defined that relevant tax policies in support and encouragement of these charitable activities be codified.

As per Article 3 of the *Charity Law of the People's Republic of China (Charity Law)*, charitable activities refer to the voluntary activities for the purposes of public welfare, done by natural persons, legal persons, or other organisations through the donation of property or in provision of services, in: 1) aiding the poor, 2) aiding the elderly, orphaned, sick, disabled, and those with special care requirements, 3) assisting in the mitigation of damages as a result of natural disasters, accidents, public health emergencies, or other emergency events, 4) promoting the development of undertakings for the development of education, science, culture, health, and sports areas, 5) preventing and controlling pollution and other public health hazards, protecting and improving the ecological environment, 6) conduction of other charitable public welfare activities in conformity to this law. Within this scope, also according to Article 3, the undertaking of the aforementioned activities by natural persons, legal persons, and other organisations could all be recognised as 'charitable events', and as such, should be naturally supported and encouraged via charitable tax policies. This is mirrored by Article 5, stipulating that the state both encourages

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and supports the practice of core socialist values by natural persons, legal persons, or organisations, which includes the promotion of traditional Chinese virtues and the conduction of charitable events in accordance with the law.

In regulation of organisations which specifically specialise in charitable ventures, namely: charitable organisations, Article 8 states that charitable organisations refer to the non-profit organisations established based upon the *Charity Law* and in compliance with its regulations, with the express purpose of engaging in charitable ventures in society. These organisations could take the forms of foundations, societal organisations, social service agencies, amongst other organisational forms. Charitable organisations, as it could be seen, are non-profit organisations established under the law with the purpose of engaging in charitable ventures.

For support provided to charitable organisations, according to the *Charity Law*, all peoples and organisations engaged in charitable ventures should be supported, and charitable activities encouraged. As charitable organisations are naturally also non-profit organisations, they would further also be able to enjoy the tax treatment as afforded to non-profit organisations. This very much aligns with the primary to tertiary redistributions, which encourages those who have attained wealth first to engage in charitable ventures, as further also supported by the government.

II. China's Current Charity Tax Policies

Amongst the various mechanisms incentivising philanthropy, tax policy is arguably the most effective policy lever. As a result, the state has formulated many charitable tax policies encouraging and supporting the carrying out of charitable activities in accordance to laws and regulations, whether it be by natural persons, legal persons, or other organisations. These laws and its varieties have encompassed charitable tax policies established since the creation of the People's Republic of China; with sources of charitable tax laws both seen within legislation and tax codes alongside tax regulatory documents, with the applicable length of these charitable tax policies being temporary or long-term, with the scope of these policies both specific or generally applicable, with mechanisms for the charitable tax policies' implementation observable in both indirect and direct means, and with the object of these charitable tax policies applicable to firms and charitable organisations but also individuals too.

Notwithstanding the wide variety and scope, due to scope and length limitations, this paper would only focus on the charitable tax policies applicable to charitable organisations and individual donations.

i. Tax Policies Applicable to Charitable Organisations

The tax policies applicable to charitable organizations have covered a wide range of policy areas, encompassing almost all types of taxes, major income streams, and property.

1. Income of charitable organizations is tax-exempt. Article 79 of the *Charity Law* stipulates that preferential tax treatment in accordance to the law could be enjoyed by charitable organisations and their income streams.

Specifically, as regulated by Article 26 of the *Enterprise Income Tax Law*, the tax-exempt incomes of charitable organizations include: (1) income from national debt interest payments, (2) qualified incomes from dividends, bonuses, and other equity investments, (3) other tax-free income that meets the requirements. Additionally, as noted within the *Notice on the Corporate Income Tax Exemptions of Non-Profit Organisations*, the incomes exempt from tax also include: (1) income from individual or organisational donations; (2) income from government subsidies other than those provided by Article 7 of the *Enterprise Income Tax Law*; (3) membership dues collected in accordance with the regulations of the civil affairs or finance departments at a provincial level or above; (4) interests from bank deposits derived from tax-free income; (5) other incomes noted under the Ministry of Finance and the State Administration of Taxation's rules.

In addition, should it meet existing regulations, income earned by charitable organizations from technology transfer could also be made tax-free. Moreover, for charitable organizations whose operations are in adherence to the legal criteria for small, low-margin businesses, a lower tax rate on their for-profit operations income could also be attained.

2. Imported donations are tax-exempt. According to Clause 2, Article 80 of the *Charity Law*, there shall be a reduction or exemption of import duties and value-added tax, according to law, for items donated for use within charitable activities.
3. Charitable activities are tax-exempt. According to Article 84 of the *Charity Law*, the state shall implement preferential tax policies for charitable activities helping the impoverished population." Moreover, according to *the Provisions of the Transitional Policy for the Pilot Project of Replacing Business Tax with VAT*, the following items are specifically exempted from VAT: (1) childcare and education services provided by nurseries and preschools; (2) Pension services as provided by pension institutions; (3) Care for the disabled population as provided by welfare institutions; (4) medical services as provided by medical institutions; (5) educational services as provided by schools engaged in academic education; (6) Cultural, sports, and other services provided by institutions such as memorial halls, museums, cultural centres, culture preservation organisations, art galleries, exhibition halls, calligraphy and art museums, and libraries.¹
4. Charitable organizations are exempt from taxes on land and housing. According to the *Interim Regulations on Deed Tax*, the deed tax will be exempted for public institutions and social organizations engaged in charitable undertakings that inherit land and houses for office, teaching, medical treatment, scientific research, and military facilities.
5. Property and land held by charitable organizations are tax-exempt. Based on the *Provisional Regulations for House Property Tax* and *Provisional Regulations for Urban Land Use*, the properties and land used by organisations engaged in charitable organisations are exempt from property

¹State Administration of Taxation (Ed.), *Basic Tax Laws and Regulations of the People's Republic of China* (2021 edition), China Taxation Press, Revised 22nd edition, January 2021, pp. 60-78.

tax and urban land use tax.

6. Charitable investments in elderly services institutions are tax-exempt. Specifically, companies, institutions, societal organisations, or individuals and other entities engaged in charitable activities pertaining to non-profit, welfare-based services institutions for the elderly population shall be exempted from taxation for property and urban land use tax.²

ii. Charitable Tax Policies for Donations by Firms and Natural Persons

With a tradition of helping the poor throughout history, and with the premise that the currently affluent groups in China have a responsibility to promote societal development and aid those still impoverished, as stipulated under China's economic development objectives; Article 80 of the *Charity Law* stipulates that natural persons, legal persons and other organizations who donate property for charitable activities may enjoy preferential tax treatment in accordance with the law.

1. Charitable Tax Policies for Corporate Donations

According to statistics from the Ministry of Civil Affairs, charitable donations in China are primarily driven by enterprises overall. As the central focus of the microeconomic environment, in influencing of their decision-making on charity and charitable donations, not only would the macroeconomic policy environment and charitable needs and objectives be considered; the entity themselves alongside their financial circumstances and characteristics would moreover yield an integral influence.

a) China's Preferential Policies Surrounding VAT and Tariff Discounts

In terms of the preferential policy provisions surrounding value-added tax and tariff discounts, there exists several incentives. For scientific instruments imported directly for scientific research, experiments, and teaching purposes; for purpose-built items imported by organisations servicing the disability population and for items imported specifically for use for the disability population, including artificial limbs, wheelchairs, and orthotics, the value-added tax for imports shall be exempt from application. For supplies directly donated for use within direct disaster relief if their quantities are within reasonable ranges, whether they be from foreign societal organisations, enterprises and firms, the overseas Chinese population and other friendly personage, the residents of Hong Kong, or compatriots from Macau and Taiwan, the value-added tax for imports alongside the consumption tax shall be exempt from application. For foreign donations of supplies by donors for the direct purposes of alleviating poverty or for the conduction of charitable ventures, the import tariffs and the value-added tax for imports shall be exempt from application. For donations to disaster-affected regions by foreign governments, societal organisations, firms, or individuals, including supplies such as foods, essential items, medication, and rescue supplies, all taxes surrounding the import process shall be exempted from application.

² State Administration of Taxation (Ed.), *Basic Tax Laws and Regulations of the People's Republic of China* (2021 edition), China Taxation Press, Revised 22nd edition, January 2021, pp. 224-238.

Additionally, according to the *Law of the People's Republic of China on Donations to Public Welfare Undertakings*, imported goods and materials donated from overseas to public welfare social organizations and non-profit public welfare institutions for public welfare undertakings shall be reduced or exempted from import duties and value-added tax in accordance with the provisions of laws and administrative regulations.

b) China's Income Tax Policies Supporting Corporate Charitable Donations

According to the Enterprise Income Tax Law of the People's Republic of China, charitable donations done by firms at an extent less than 12% of its total annual profits may be deducted during calculations of taxable income. Here, 'total annual profits' refers to the annual profits calculated under China's unified system of accounting done by the firm. 'Charitable donations', as regulated under the Law of the People's Republic of China on Donations for Public Welfare, refers to firms' donations which is done through the intermediary of charitable societal organisations or the People's Governments at a County level or above for a charitable purpose; with charitable societal organisations in this sense referring to societal organisations such as foundations or charitable organisations in adherence to the regulatory criteria.

Beyond this deduction, for donations to specific societal organisations, there are also additional tax discount rules. First, for companies and institutions, and for societal organisations and other entities, the extent of the charitable donation may be completely deducted from taxable income prior to the payment of corporate income tax should the donation be provided to non-profit societal organisations and government bodies towards charitable, non-profit entities providing for services to the elderly. Second, for the operational units of firms, and for societal organisations and other entities, the extent of the charitable donation may also be completely be deducted from taxable income prior to the payment of corporate income tax should the donation be used towards charitable youth activity centres (or their construction), and with the donation done via the intermediary of non-profit societal organisations or governmental bodies. Third, for the money donated to be spent on developing new products, technologies, or manufacturing processes by non-profit institutions, with a non-profit motive, and with no ties to the donor firm, the extent of the donation may also be fully deducted from their taxable income following approval by the relevant governmental taxation authority.

Moreover, according to the *Notice of the State Council on Approving and Relaying the Several Opinions of the National Development and Reform Commission and Other Departments on Deepening Reform of the Income Distribution System* (Guofa [2013] 6) and the *Notice of the General Office of the State Council on Deepening the Division of Key Work for Income Distribution System Reform* (GuoBanHan [2013] 36) with the relevant rules, the extent of a firm's charitable donations above 12% of its total annual profits may be carried over for deductions within later years.

c) China's Other Tax Policies Supporting Corporate Tax Donations

- i. In terms of stamp duty, according to the *Provisional Rules of the People's Republic of China on Stamp Duty*, all donations by owners towards government bodies, societal welfare units, and

- transfer to schools of property titles shall be exempted from stamp duty.
- ii. In relations to the policies surrounding the value-added tax for land, the terms of 'transfers of land use rights or transfers of ownership of the structures atop the land for monetary income' refers only to actions including the selling of property, or with transactions in other forms involving payment for the changing ownership of property. This definition surrounding stamp duty does not apply in relations to inheriting of property or the gifting of property, or other forms where no monetary amount is received. Such, should the owner of the property or the owner of the land use rights of the property donate their property or land use rights to other societal organisations, this exemption from stamp duty will also apply. In 1995, the Ministry of Finance and the State Administration of Taxation's *Notice on the Provisions on Some Specific Issues Surrounding the Value Added Tax for Land (Cai Shui [1995] 48)* have only codified the scope of 'gifting' as a term. Within it, there has been an inclusion specifically of the actions by property owners and owners of land use rights to donate those assets in support of education, civil affairs, welfare, or other activities in the public interest through domestic non-profit societal organisations or government bodies.

2. Charitable Tax Policies for Individual Donations

According to Clause 3, Article 6 of the *Individual Income Tax Law of the People's Republic of China (Individual Income Tax Law)*, individual donations to the charitable causes of education and poverty alleviation, to an extent less than 30% of its taxable income may be fully deducted for taxable income calculations. Administratively, according to the *Announcement of the State Administration of Taxation on the Individual Income Tax Policy for Donations to Public Welfare and Charitable Undertakings (State Administration of Taxation [2019] 99)*, this deduction according to the *Individual Income Tax Law* applies to donations for charitable purposes including education and poverty alleviation when donated through charitable organisations at a domestic level or through the People's Government or other relevant government institutions at a County level or above.

- a) In terms of the rules surrounding individuals' charitable income expenditure deductions, the deductions would apply towards classified and comprehensive income from property rental, property transfer, interests and dividends, and other sources. Should the deductions exceed the income from one particular category in the current period, the remainder could be subsequently deducted from other income categories too.
- b) Additionally, should the donation expenditure of an individual be deducted from either the comprehensive income or from income from business operations, then the limit for these deductions would be 30% of the taxable income from the respective applicable categories within the year. However, should the deduction be done for one's classified

income, then the limit would rather be 30% of the taxable classified income from the month in consideration. Additionally, according to the Individual Income Tax Law, for other charitable ventures, it is possible for the State Council to also allow donations to be fully deducted from taxable income before income tax calculations.

- c) Beyond these policies, individual donations of property rights and land use rights are also exempt from tax. According to the *Detailed Rules for the Implementation of the Interim Regulations of the People's Republic of China on Value-added Taxes for Land* (CaiFaZi [1995] 6), and the *Notice on the Provisions on Some Specific Issues Surrounding the Value Added Tax for Land* (Cai Shui [1995] 48), actions by property owners and owners of land use rights to donate those assets in support of education, civil affairs, welfare, or other activities in the public interest through domestic non-profit societal organisations or government bodies are exempt from value added taxes for land.
- d) For individual donations in terms of stamp duty, according to the *Provisional Rules of the People's Republic of China on Stamp Duty*, all donations by owners towards government bodies, societal welfare units, and transfer to schools of property titles shall be exempted from stamp duty altogether.

3. Charitable Tax Policies for the Beneficiaries of Charitable Donations

According to Article 81 of the *Charity Law*, the beneficiaries of the charitable donations shall receive tax benefits according to the law. Such, according to the *Individual Income Tax Law* and other regulations surrounding its implementation: state-issued relief funds are firstly exempted from individual income tax. Income for disabled peoples, the solitary elderly, survivors of diseased veterans from combat, alongside other income approved by governmental finance ministries may also be exempted from income tax. Additionally, should the charitable organisations, with their charitable services and payments, be in the categories of poverty alleviation, relief, and assistance for the disabled, these beneficiaries of payments may also be able to access tax benefits in accordance with the *Individual Income Tax Law*.

Firms and individuals within disaster-affected areas who have accepted donations and supplies from charitable organisations are also exempted from income tax for these donations and supplies.

III. Directions for Improvement of China's Charitable Tax Policies

With China's annual total GDP now exceeding 100 million yuan, and with the national, annual per capita income also exceeding US\$10,000, there has been a significant improvement in the people's living standards, with decisive progress already being made in holistically constructing and improving the Chinese society. China has already entered a new stage of development, to embark on its journey of building a modern, socialist nation in all ways.

Within the status quo, whilst absolute poverty has been all but eliminated, concerns of relative poverty would still exist in the long term. For the eventual goal of common prosperity to be achieved, there must be a necessity to especially focus on the tertiary distribution of income; with philanthropy being such an important mechanism to truly resolve issues of insufficient and uneven development.

Observing China's current tax policies surrounding philanthropy, it could already be seen regarding its larger scope, a greater range of policies, and with a clear target objective for philanthropy overall. As a result, it has clearly played a positive role supporting and encouraging philanthropy's development, though there continues to be room for improvement, especially in observation of the policies of other nations as underlaid by a recognition of China's circumstances from an empirical point of view.

i. Improvements to Charity Tax Policies

Overall, there is still room for improvement in China's charity tax policies. In the future, there is still possibility for the expansion in scope of the definition of charitable organisations, the increasing of incentives for charitable donations, and also for individual donations to be further encouraged, such as through the establishment of a system resembling the current policies for corporate charitable donations, in allowing individual charitable donations to be carried over if the extent donated has exceeded the limit for donations within a certain year. The preferential tax policies for natural persons, legal persons, and other organisations donating property to further charitable activities may also be further clarified in the future.

ii. Improvements to the Implementation of Charity Tax Policies

As noted by the *Opinions on Further Deepening the Reform of Tax Collection Administration Issued by the General Office of the CPC Central Committee and the General Office of the State Council*, initiatives will be taken for China to modernize its tax collection and administration, to establish a 'smart taxation' system, to realise the goals for the holistic collection of information and of interdepartmental communication and integration. This is to improve the coverage and convenience of taxation services, to truly allow the taxpayer to complete its tax administration requirements completely online.

Additionally, technological solutions could also be leveraged to further the implementation of preferential tax policies, such as the promotion of a system of mutual recognition of charitable donations receipts across provinces, the furthering of digitisation of donation receipts, and the simplification of individual tax declaration and deduction procedures. A unified, national account for charitable donors may also be established by the taxation arms of government, to provide greater convenience for donors to obtain pre-tax deductions for charitable donations; and an automatic system of deductions also potentially able to be developed, where the charitable donations recognised by the State Administration of Taxation donated towards eligible non-profit organisations, should it be below the limit for income tax deductions, may be automatically calculated without needing further action by the taxpayer themselves. This could, such, provide for greater convenience for the taxpayer surrounding their charitable donations overall.

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