The International Experience of Personal Income Tax Reform and China’s Practice

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Abstract. Individual income tax plays an important role in China's tax structure. The reform of personal income tax has always been the focus of China's tax reform. However, there are still some problems in China’s personal income tax system. It does not play its due role in regulating income distribution. This paper focuses on the tax system of taxable unit, expense deduction standard, tax rate and so on in the United States and Japan. And proposes that in the process of individual income tax reform in China, it is necessary to perfect the tax collection and management system, improve the expense deduction standard, and adjust the tax rate structure. It is recommended that accelerating the establishment of a mixed tax system for individual income tax in China and a shift from individual taxable units to family-based taxable units.

Introduction

Personal income tax is an important tax in China's taxation structure. On the one hand, it plays the role of expanding fiscal revenue, on the other hand, it plays the role of regulating the redistribution of income gap. Compared with other taxes, its impact on social family income and consumption is more obvious. With the development of the economy and the increase of people’s income channels, the pace of personal income tax reform needs to be steadily accelerated. On March 5, 2018, the first meeting of the 13th National People's Congress was held in Beijing. Premier Li Keqiang clearly stated in the government work report: "Improve personal income tax thresholds, increase deductions for special expenses such as education for children, medical treatment for serious illness, and reasonably reduce the burden, and encourage the people to increase their income through labor." Personal Income Tax Reform has become a hot topic, numerous proposals have been put forward to raise the personal income tax threshold and reduce the tax burden. This shows that China’s emphasis on the reform of individual income tax and the urgency of the reform of personal income tax at this stage.

The collection of personal income tax in China began in 1980. Afterwards, the individual income tax thresholds and tax rates are constantly adjusted[1]. Individual income tax is increasing in the proportion of China's taxation system. However, the effect of adjusting the income gap is poor. In the process of individual tax reform, we should not only adapt to the development status of China's economy, but also learn from the mature personal income taxation experience of developed countries. Take its essence and go to the dross, and make the personal income tax policy of China more perfect. The US personal income tax began to be collected in 1861, and became a permanent tax in 1913. Its development is more mature and can provide experience for the reform of personal income tax in China. As one of the developed countries in Asia, Japan's development status and background are similar to those of China. So its personal income tax system can also provide reference for our country.

The Relevant Theoretical Basis of Personal Income Tax

Personal Income Tax System Model

Comprehensive Tax System. The comprehensive tax system refers to the taxpayer’s income, such as wages and salaries, labor remuneration, dividends, and property leases, which are not
classified into categories, but are aggregated. And the corresponding preferential policies and
deductions are determined according to the total amount. On this basis, the taxable income is
determined, and then find out the corresponding tax rate according to the personal income tax
progressive tax rate table and calculate the personal income tax payable.

**Classified Tax System.** The classified tax system refers to the taxpayer's income is classified
according to the nature of income and source of income. Then find out the corresponding deduction
standards and preferential policies. Finally, calculate the taxable income of each category of income
on this basis. The individual income tax is calculated and paid according to the corresponding tax
rate.

**Mixed Tax System.** The mixed tax system refers to the combination of a comprehensive tax
system and a classification tax system. Taxpayers' income is classified first, for those relatively
stable and continuous incomes, such as wages and salaries, a comprehensive tax system is used; and
for those incidental income, classified tax system is used.

**Individual Income Taxable Unit**
The taxable unit refers to the unit of measurement and the standard of payment of the taxable object.
The taxable units of personal income tax are mainly divided into individual taxable unit and family
taxable unit.

**Individual Taxable Unit.** Individual taxable unit, that is, regardless of the marriage state of
resident, resident is taxed according to their personal actual income. The higher the income, the
higher the individual income tax payable, and the higher the marginal tax rate of personal income
tax.\(^2\)

**Family Taxable Unit.** Family taxable unit, that is, family as the unit and combine the income of
both husband and wife together to pay taxes. As the basic unit of society, and the place where
income and wealth gather, as well as the basic unit of expenditure and consumption. The standard of
living and purchasing ability of a family are related to the income of the family. Therefore, family
as the taxable unit is more equitable than individual as the taxable unit.\(^2\)

**Comparative Analysis of Personal Income Tax among China, the US and Japan**

**Personal Income Tax System in U.S.**
The U.S. personal income tax law has been implemented since 1913. After many revisions and
improvements, the U.S. personal income tax law is more mature and can provide references for
China's personal income tax reform.

The U.S. personal income tax implements a comprehensive tax system, and family taxable unit.
For a long time, the United States' personal income tax collection and management system has been
continuously improved, and the higher level of tax collection and management has laid the
foundation for the United States to implement the comprehensive tax system. The selection of
American taxable unit also evolved from individual to family. Between 1913 and 1948, U.S.
personal income tax had just formed a permanent tax and started to collect. In this period, individual
is as the taxable unit. Regardless of whether married or not, individual income tax is paid according
to the individual’s actual income. It guarantee principle of “marriage neutrality”. But due to the
differences in taxation systems between regions and the differences in income within households,
there is a large gap in the individual income tax paid by families with the same income, which
violates the principle of tax fairness. As a result, the United States began to reform the personal
income tax system. In 1948, the Income Act was promulgated, which changed the individual
taxable unit to family taxable unit. And all couples within the United States are allowed to pay taxes
after sharing their income equally. However, since the individual income tax is progressive, the
average income leads to the reduction of the government tax revenue, which violates the principle
of “marriage neutrality”. In order to solve this problem, the United States enacted the "Taxation
Reform Act" in 1969, setting up four tax rate table.\(^2\)
**Personal Income Tax System in Japan**

The Japanese personal income tax system adopts a mixed tax system. For fixed income, such as wages, salaries, dividends, etc., a comprehensive method is used. And pay the tax at the end of the year. However, for other non-fixed income, the method of classification is adopted. On the one hand, it ensures the stability of the tax revenue source. On the other hand, compared with the comprehensive tax system, it does not require such a high level of taxation costs.\(^3\)

In the respect of taxable unit, Japan also chose to use family as taxable units. On the one hand, the family taxable unit will reduce taxation costs. On the other hand, it helps to avoid transferring income between husband and wife to reduce taxation.

It is worth mentioning that Japan has a special expense deduction standard. In Japan, the excess regression rate system is used in the expense deduction standard in both wages and salaries. This method can better control the deduction of expense of the high-income groups within a certain range.\(^3\)

**Personal Income Tax System in China**

China currently implements the classified tax system. The scope of taxation is divided into 10 categories. Although this tax system is helpful to control the source of tax and save the cost of paying taxes, But taxpayers with single income sources often bear more tax burden than those with wide income sources. It will not only lead to the loss of personal income tax revenue, but also very unfair to taxpayers. The mixed tax system can reflect the ability-to-pay principle of taxation, and it can better play the role in adjusting income distribution gaps and ensuring social fairness.

China currently chose to use individual as the taxable unit, which is beneficial to the realization of the principle of “marriage neutrality”, but cannot achieve the goal of “tax fairness”. Individual taxable unit focus on the adjustment of personal income, while family taxable unit pay attention to the adjustment of household income. But in the final analysis, people's income level, consumption, and decision-making are all affected by the family. The family is the basic unit of society. Therefore, it is more reasonable to use family as taxable unit.

**Comparative Analysis of the Utility of Personal Income Tax in China, the United States and Japan**

The main role of personal income tax is to provide financial revenue for the country, and secondly, to adjust the income gap and ensure social equity.

We use the Gini coefficient to judge the fairness of a country's income distribution. Its value range from 0 to 1. The smaller the value is, the more fair the income distribution is. 0.4 is the internationally recognized “alert line” of the income distribution gap. The Gini coefficient of China and the United States are similar, and both are higher than 0.4. Japanese Gini coefficient has been below 0.4.

In addition, from the perspective of the contribution of personal income tax to national financial revenue, the United States is far more than China. On December 12, 2017, at the Global Investment Summit of Wall Street in 2018, Jia Kang, remember of the CPPCC National Committee and the former Director of the Institute of Financial Science Research of the Ministry of Finance, published the "China's Policy to Trump's tax cuts", which states: " After several rounds of reforms, China’s personal income tax is clearly lacking in rationality, accounting for only 6% of the total fiscal revenue, and is clearly marginalized; the U.S. personal income tax accounts for 47% of the federal tax revenue.”

**Conclusions and Policy Recommendations**

**Improve the Tax Collection and Management System**

First, establish a unified personal income tax management information system covering the whole country.\(^4\) Using computers and the Internet, and joint public security, banking, third-party payment,
customs, the education department, and the health departments to investigate and statistics the actual income and family situation of citizens. At this time, the government should pay attention to protecting the privacy of citizens. Under the condition of the gradual improvement of individual income tax information collection, it is advantageous to carry out the mixed tax system and family taxable unit. Second, simplify the application procedures of personal income tax. For fixed incomes, such as wages and salaries, we can use comprehensive tax system. Monthly prepayment, year-end clearing. For changing income, we can use classified tax system. In addition, taxpayers are encouraged to pay their tax by themselves and increase their ability to pay individual income tax independently. Finally, the individual income tax laws should be more perfect. We must formulate corresponding laws to punish those withhold agents who have not withheld taxes and those individuals who take unlawful means to evade tax.

**Improve the Expense Deduction System**

China's personal income tax system implements classified tax system, so the cost deduction system also adopts the method of classified deduction. The quota and fixed rate are combined. Such method is based on the individual’s income and do not take into account factors such as the personal debt, family burden and so on. Japan adopts the mixed tax system. Correspondingly, its cost deduction system is also a combination of integration and classification. In the following personal income tax reform, we should learn from the Japan's cost deduction system and improve the cost deduction items. For example, the livelihood deductions should increase the livelihood costs of the average family, such as education expenses, medical expenses, alimony, mortgages, etc. In designing livelihood deductions, factors such as inflation must be taken into account. Adjust the living expense deduction standard according to the inflation rate, so that the individual income tax is more fair.

**Adjust the Tax Rate Structure**

In order to adapt to the change from “individual taxable unit” to “family taxable unit”, we need to adjust the structure of tax rates to make the individual income tax more equitable. In the United States, taxpayer has been divided into four categories, and adopt different tax rate. This method fully considers the differences in family circumstances, and it is more fair and reasonable.

Judging from the current personal income tax rate in China, the excess progressive tax rate is applied to the salary income, while the proportional tax rate is used for other remuneration of labor, dividends, etc., which results in low-income and middle-income families relying mainly on fixed wages bear a heavier tax burden than those high-income families whose income are mainly derived from remuneration of labor, dividends, etc. Meanwhile, personal income tax revenues are also lost. In view of this phenomenon, we cannot simply reduce or raise the tax rate, and we must adjust the tax rate structure. First, labor income and non-labor income should be reintegrated. Wages and salaries, remuneration of labor, self-employed income, contracted rental income should all be attributed to labor income, and five level of excess progressive tax rate should be implemented in a unified manner. On the one hand, it will help simplify the collection, on the other hand, it will help to avoid the problem of transferring income under two kinds of excess progressive tax rates. At the same time, the five-level excess progressive tax rate will reduce the marginal tax rate, which is also of great significance for maintaining social stability. Second, when setting the personal income tax rate, the condition of overall family income should be considered. The level of excess progressive tax rate should be set according to the average household income to make the tax more fair. Finally, referring to tax systems of the United States and China's national conditions, it is proposed that China could design two personal income tax rate tables, one for individual and another one for family, and coordinate the tax rates of the two.

**References**


