



CHINA TAX RATIONALIZATION

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There have been some discussions in the press including the China Daily calling for rationalization of taxation and alleviation of citizens' feeling about the tax burden being too heavy. The press appeals to the professionals to share their views. We hereby attempt a response.

It is indeed very important that taxpayers feel comfortable about paying the right amount of tax. Most should have no objection to the reality that tax is a necessary cost of living in any modern civilization where governments need funds to maintain law and order, administer social welfare and provide security and defense. The question is whether taxpayers feel what they receive justifies the burden they share.

Equity and fairness is a matter of degree in the overall scheme of things. One therefore should look at the entire spectrum of the country's revenues and expenditures in assessing if the overall structure gives a good sense of balance. We can then move on to look at the desirability of individual systems and technical features.

From our recollection, Hong Kong in the 1970s had a similar attempt to search for an answer to the same question. What we have seen in the years to follow is that Hong Kong has a revenue structure with a shape roughly as follows: 60/40 between tax and non-tax revenues, and 60/40 between direct and indirect taxes. While Hong Kong and the Mainland differs greatly in many respects, we believe good thoughts can be universally relevant. At least, we can take that as a starting point in our search for an optimal shape for China's revenue structure.

Let's firstly look at China's current revenue structure. According to China's fiscal budget for year 2011, total budget revenues of the country for the year is 8,972 billion (in RMB, and for all amounts to follow), total expenditure, 10,220 billion, resulting in a deficit of 900 billion, after a transfer of 150 billion from the budget stabilization adjustment fund. There has been speculation that total revenues for the year will be over 10,000 billion, making year 2011 another year of spectacular growth in fiscal revenue, over 20%, well above that of the GDP growth. For now, we would leave the interesting issue of the rate of revenue growth and focus on the structure itself.

We can analyze the structure in two ways, as mentioned above: tax and non tax revenue (See Schedule 1), and direct and indirect taxes (See Schedule 2). The shape of the structure is roughly like this: 88/12, between tax and non-tax revenues; and 30/70, between direct and indirect taxes. What does it tell?

China relies heavily on tax revenues to fund government operations, and the lion's share of the tax revenue is indirect taxes. An intuitive conclusion of such an observation is that the expenditure programs are funded in the main by the average citizen in terms of effective tax burden due to the regressive nature of indirect taxes. With this, we need to have an informed debate if it is a valid conclusion; and if so, how the current structure should be reshaped before we move on to deal with the particulars.

SCHEDULE 1

Tax Revenue	-	<u>7,929.10</u>	<u>100.00%</u>	<u>88.38%</u>
Value added tax - VAT		2,342.70	29.55%	26.11%
Corporate income tax - CIT		1,381.00	17.42%	15.39%
Business tax - BT		1,199.00	15.12%	13.36%
Import taxes - VAT & CT		1,122.00	14.15%	12.51%
Consumption tax - CT		650.00	8.20%	7.24%
Individual income tax - IIT		520.00	6.56%	5.80%
Deed tax - DT		263.00	3.32%	2.93%
Customs duty - CD		217.00	2.74%	2.42%
City maintenance tithes		204.00	2.57%	2.27%
Car purchase tax - CPT		192.70	2.43%	2.15%
Land appreciation tax - LAT		138.00	1.74%	1.54%
Stamp duty - SD		110.00	1.39%	1.23%
Urban land use tax - ULT		108.00	1.36%	1.20%
Property tax - PT		99.00	1.25%	1.10%
Farm land tax - FLT		95.00	1.20%	1.06%
Resources tax - RT		51.00	0.64%	0.57%
Vehicle tax - VT		26.00	0.33%	0.29%
Tobacco tax - TT		8.40	0.11%	0.09%
Ship Tonnage tax - ST		2.80	0.04%	0.03%
Export tax refund - VAT & CT		(800.50)	-10.10%	-8.92%
Special programs		215.00	20.62%	2.40%
Administration fees		320.00	30.68%	3.57%
Foreclosures		112.20	10.76%	1.25%
Others		395.70	37.94%	4.41%
Non Tax Revenue		<u>1,042.90</u>	<u>100.00%</u>	<u>11.62%</u>

SCHEDULE 2

	<u>Direct</u>	<u>Indirect</u>
	<u>2,394.80</u>	<u>5,534.30</u>
Tax Revenue	<u>30.20%</u>	<u>69.80%</u>
Value added tax - VAT	-	2,342.70
Corporate income tax - CIT	1,381.00	
Business tax - BT		1,199.00
Import taxes - VAT & CT		1,122.00
Consumption tax - CT		650.00
Individual income tax - IIT	520.00	
Deed tax - DT		263.00
Customs duty - CD		217.00
City maintenance tithes		204.00
Car purchase tax - CPT		192.70
Land appreciation tax - LAT	138.00	
Stamp duty - SD		110.00
Urban land use tax - ULT	108.00	
Property tax - PT	99.00	
Farm land tax - FLT	95.00	
Resources tax - RT	51.00	
Vehicle tax - VT		26.00
Tobaccos tax - TT		8.40
Ship Tonnage tax - ST	2.80	
Export tax refund - VAT & CT		(800.50)