

The analysis of difficulties in the taxation reform and its solutions in China

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The reform of the tax system is the highlight and the key link of the future reform. However, the reform of the tax system cannot be accomplished in one step, and there are many difficulties, including the difficulty of coordinating with the comprehensive deepening reform, improving the function of the tax system, adjusting the relationship between direct tax and indirect tax, constructing the local tax system and connecting with the tax administration, etc. The analysis of these difficulties separately helps sort out the ideas of tax reform and better promote the tax reform.

Keywords: tax system function, difficulties of reform, direct tax

Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform (hereinafter referred to as the “Decision”), adopted at the Third Plenary Session of the Eighteenth Central Committee, made a comprehensive deployment and strategic layout for deepening reform of the fiscal and tax system. The reform of the fiscal and tax system is a key point and a breakthrough in the future comprehensive reform. Tax system, through a variety of ways and means, deeply impacts on the economic, social, ecological, cultural and other fields. The tax reform will be a key link of the comprehensive deepening reform, and it will also be a system innovation based on global and long-term perspective. But the tax reform, has never been achieved in one step, but needs to consider many influencing factors and has many problems. Understanding and deeply grasping the difficulties faced by the tax reform is conducive to better sort out the ideas of tax reform, to identify the difficulties of tax reform, and to better promote tax reform.

1. The analysis of the difficulties of tax reform

1.1. The current tax system is mainly focused on matching economic system reform, and difficult to adapt to need of the comprehensive deepening reform

In terms of its goal, the past tax reform was mainly focused on the economic system, and committed to improving the socialist market economic system. As Deng Xiaoping

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said, economic development was the absolute principle, and only if the economy develops, can other issues be solved. Therefore, focusing on improving the market economy system must be the main line of the past tax reform. Specifically, the 1994 tax system, focused on the economic system, was to be adapted to the establishment of the socialist market economic system. Whether the following VAT transformation reform, consumption tax reform, or corporate income tax reform, was mainly a periodical and partial tax adjustment for the 1994 tax system, and the aim that tax system served to the economic reform was not changed all along. In particular, tax reform was focused on tax revenue growth that matched economic growth; tax revenue was directly applied to the public expenditure related to economic growth, forming the economic interaction between tax and expenditure; and the tax system was always centered on the economy, as the large number of preferential tax policies were the obvious evidences.

It is nothing wrong that tax system is concerned about the economic system reform and contributes to stable and rapid economic development, but the national governance is not limited to the economy, but also includes political, cultural, social, ecological and other diverse values. The modernization of national governance system and governance capacity requires that tax reform cannot be ‘one-sided’. The tax system, which lacks compatibility with the economic, cultural, social, ecological and other values, is not required by the modern tax system.

The future tax reform is supposed to be aimed at the overall goal of comprehensively deepening reform, to break through the currently limited and one-sided thought, and promote reform overall, comprehensively and rationally to achieve the diversified target. But how to adapt the current tax system to the objectives of comprehensively deepening reform, and how to shift the focus of tax reform to balance the multiple values, meet with unprecedented challenges.

1.2. The current tax financing function is outstanding, but other functions are difficult to be improved effectively

We analyzes from the perspective of tax revenue structure. At present, tax system focuses on the function of financing, commodity turnover tax and income tax are the double main tax categories and VAT. Specifically speaking, business tax and corporate income tax constitute the current main tax categories. VAT, business tax, corporate income tax have characteristics of extensive and stable tax base. The current tax system ensures the sufficient revenue through these tax categories. At the same time, the financing capacity of other taxes is quite limited. In 2015 for example, in addition to VAT, corporate income tax, business tax, consumption tax, individual income tax, the tax revenue proportion of remaining 13 tax categories, are all below 3.5%. Among them, the tax categories accounting for below 1% in the tax revenue proportion include resource tax, stamp duty, vehicle and vessel tax, tobacco tax, ship tons of taxes and other taxes.

The function of the tax system is not only achieved through the main tax categories, but also through the auxiliary taxes. But the tax functions of these auxiliary taxes are difficult to be revealed on account of their inapparent financing capacity and the problems of the tax system, and reform of auxiliary taxes tend to be often neglected in the previous tax reform. Therefore, the current tax system ensures adequate revenue, but to some extent ignores other functions, especially to regulate distribution and to save resources.

The “Decision” pointed that the future tax system should highlight the function to adjust distribution and promote structural optimization. But how to achieve these functions? Through which taxes to achieve the corresponding functions? How to arrange the taxes? What are the difficulties with tax reform? These problems require the whole arrangement and consideration of the overall tax system, as well as the general control of the timing of reform, the effect of reform and the ease of reform. Therefore, in order to enhance tax function, comprehensive consideration, general arrangement, and assessment of situation are needed.

1.3. The structural adjustment between indirect tax and direct tax encounters real problems

Due to the transferability of the tax burden in the current tax structure with indirect tax serving as main tax, the substantial proportion of the tax burden in the commodity price and the diminishing marginal consumption propensity of the consumers, the tax burden of the current tax system is mainly borne by the middle-and-low-income people. Moreover, the uncertainty distribution of tax burden of indirect tax is not conducive to the judgment and decision of tax system and tax policy. The evolution of the pattern of tax system in the human society from the original direct tax to the indirect tax, and ultimately to the developed direct tax, embodies the unremitting pursuit of fair and equitable tax burden (Gao, 2015). Therefore, tax reform from the indirect tax to the direct tax is necessary. The concept in “Decision” of tax reform of gradually increasing the proportion of direct taxes in the whole tax and of promoting social equity, contains requirements of fair distribution of tax burden, and expectations of promoting social equity by the direct tax. But to adjust the status of direct and indirect taxes, we are faced with the following questions:

1.3.1. The adjustment between indirect tax and direct tax is subject to the pressure of fiscal expenditure

In the entire tax system, to increase the proportion of direct taxes, and even to achieve the changes from the tax structure dominated by indirect tax to by direct tax, means that the model of future tax growth will change radically. In the current indirect-

tax-dominated system, tax revenue growth is mainly due to the growth of ad valorem tax, and the source of tax revenue is mainly GDP. If the purpose is to transform into a direct-tax- dominated system in the future, the tax growth model will be distinct from the present. The increase of direct taxes will directly lead to an increase of taxpayers' tax burden. The process of tax revenue growth in the direct-tax- dominated system is a process of full game and competition between tax authorities and natural taxpayers and also a process of the direct conflict of tax interest. In the direct-tax-dominated system, tax growth will be a slow process. At the same time the changes of tax structure from the indirect tax to the direct tax implies an important prerequisite that the government's public expenditure pattern and the scale should be in a relatively stable state, otherwise there will be a contradiction between a slow increase or no increase in tax revenue and the expansionary demand of fiscal expenditure. China is in a stage of comprehensively deepening reform, and to strengthen the public expenditure's function is still essential on account that the government needs to strengthen government functions and role and to make up for market failure, to reduce effectively the burden of people's livelihood, etc. In this case, the steady increase of tax revenue is the guarantee. But whether direct tax is competent to the task of tax revenue growth and how it will lay out have become a key issue.

1.3.2. It is difficult to break through the direct tax reform in the short term

Individual income tax and real estate tax are typical representatives of the direct tax. In this part by the discussion of difficulties of the corresponding reform, we analyze the problems faced by the direct tax reform.

The proportion of individual income tax in the total tax has been stable at 6-7% in more than 30 years, which means that with the trend of income growth and GDP growth and the tax model unchanged, its proportion cannot be directly increased, and the function of adjusting income distribution cannot be fulfilled. To change this situation, the classified individual income tax system at present shall be transformed into a classified-and-comprehensive income tax system. However, some scholars (Bai, 2009) pointed out that the transformation of the taxation model need overcome institutional problems. The separation and transfer of tax revenue between the place of the income source and the place of tax declaration results from the discrepancy between the place of the income source and of residence due to the fact that in the mode of classifications individual income tax is withheld from the source of income while in the pattern of comprehensive revenue individual income tax is to be self-declared in the residence or the domicile place of the taxpayer. In 2015 for example, the local shared part of individual income tax of 344.68 billion RMB will need to be transferred between the place of the income source and of tax declaration, the amount accounting for 4.15% of local public revenue, which will inevitably be met by strong opposition of the

corresponding local governments. Further, at the time of final settlement of tax budget, the tax revenue of the place of the income source has actually been deposited and may have been expended, and it is clear that the local governments which collect taxes from different places of income source cannot share it at this time and the tax benefit between the two places cannot be coordinated.

Although housing property tax pilot reform in Shanghai and Chongqing has been executed for many years, thoughts and programs for the nationwide housing property tax reform need to be clarified. It is difficult to decide how to proceed the future tax reform. In summary, the difficulties of reform of house property tax are mainly focused on the certainty of the scope and of tax elements; the coordination between housing property tax reform and the whole tax system; the comprehensive impact on taxpayers and government revenue, etc. For example, whether the tax base of housing property tax is on a wide tax base without any tax exemption policy or per capita tax-free area or amounts levied is still in debate. With regard to different programs, their policy implications, scope of taxation, and incidence of taxpayer, are significantly different. The above problems make the housing property tax reform difficult to promote further.

1.4. The reconstruction of the local tax system is suffering unprecedented challenges

1.4.1. Local tax system is restricted by the tax sharing system

Under the tax sharing system, the sources of local fiscal expenditure include transfer payments and tax returns, shared-tax, local tax, non-tax revenue and so on. Table 1 shows that the transfer payments and tax returns account for 38-47% of local fiscal expenditure, and are the largest local financial sources. Shared-tax and non-tax revenue in budget also take a place in local public finance. In contrast, the position of the local tax in the local public finance is much lower than the transfer payments and tax returns.

Table 1

Source of funds for local government expenditure

Unit: One hundred million yuan, %

	Local tax revenue	Local public finance expenditure	Proportion of local tax to local public finance expenditure	Transfer payments and tax returns	Proportion of transfer payments and tax returns to local public finance expenditure	shared tax	Proportion of shared tax to local public finance expenditure	Non - tax revenue in local public finance	Proportion of non - tax revenue in local public finance to local public finance expenditure
2002	3613.1	15281.45	23.64	6766.45	44.28	3353.79	21.95	1548.11	10.13
2003	4421.5	17229.85	25.66	7379.87	42.83	3557.03	20.64	1871.45	10.86
2004	5606.7	20592.81	27.23	8699.44	42.25	4495.25	21.83	1791.42	8.7

	Local tax revenue	Local public finance expenditure	Proportion of local tax to local public finance expenditure	Transfer payments and tax returns	Proportion of transfer payments and tax returns to local public finance expenditure	shared tax	Proportion of shared tax to local public finance expenditure	Non - tax revenue in local public finance	Proportion of non - tax revenue in local public finance to local public finance expenditure
2005	6827	25154.31	27.14	10053.55	39.97	5622.08	22.35	2651.68	10.54
2006	8323.2	30431.33	27.35	12127.75	39.85	6859.06	22.54	3121.32	10.26
2007	10978.4	38339.29	28.63	14766.67	38.52	8273.68	21.58	4320.5	11.27
2008	13264.5	49248.49	26.93	20598.7	41.83	9989.34	20.28	5394.68	10.95
2009	16091.9	61044.14	26.36	28441.55	46.59	10065.55	16.49	6445.15	10.56
2010	20522.5	73884.43	27.78	33271.39	45.03	12178.94	16.48	7911.56	10.71
2011	25950.2	92733.68	27.98	40186.57	43.34	15156.58	16.34	11440.37	12.34
2012	30677.46	107188.3	28.62	46110.05	43.02	16636.39	15.52	13759.21	12.84
2013	35017.95	119740.3	29.24	50729.18	42.37	18872.2	15.76	15120.28	12.63
2014	37607.91	129215.5	29.1	53338.91	41.28	21531.55	16.66	16736.67	12.95
2015	39608.46	150335.6	26.35	67333.58	44.79	23053.06	15.33	20340.11	13.53

Note: The local tax in the above table does not include shared-tax by the central and local governments.

Source: China Statistical Yearbook.

Actually, the current funding pattern of local public expenditure is the active result of the tax-sharing system, which takes the fiscal resources as the primary distribution principle. The current vertical fiscal relationship relies too much on the shared tax and transfer payments to achieve financial balance. But whether the distribution pattern of the vertical fiscal resources currently should continue? The fiscal system has also evolved from the tax-sharing system to the present ‘money-sharing system’ (Gao, 2014) because the large amount of local government expenditures have been financed by the transfer payment. The ‘money-sharing system’ blurs the significance of the local tax system. With the promotion of replacing business tax with value-added tax (VAT), ‘money-sharing system’ is more prominent. How the tax-sharing system will be reformed and how the local tax system will be reconstructed to become a top priority in the public financial fields. In addition, quite a few shared taxes, such as VAT and corporate income tax, hold the balance of vertical fiscal resources, but the inherent economic attributes of different taxes are ignored to a great extent.¹

¹ The ideal place for VAT in the fiscal system is to be a central tax, because VAT has a natural central tax advantages. VAT is the turnover tax, the ultimate tax burden of which is on the consumer side, but in China, the characteristics that VAT is levied in the production side and taken as a shared tax, make the local government obtain a great amount of revenue through the local production enterprises. In this case, local governments have the incentives to pursue quantitative economic growth. The current fiscal system treats VAT as a shared tax between the central and local governments, and its consequences are to ignore the inherent economic attributes of these taxes and to result in the deviation between tax and its source.

Therefore, the “Decision” pointed that the tax attributes should be considered and the revenue division between central government and local governments should be further rationalized in the future. But how does the government scientifically and rationally divide tax categories? There is no definite answer currently.

1.4.2. The local tax system is restrained by taxation reform

Although the local tax system mainly serves local public finance, as a key part of the tax structure, its arrangements need to be considered in the overall tax reform framework. At present, as to China’s taxation, the function of raising revenue is outstanding, nevertheless, it has the following problems: the tax structure is unreasonable; the functions of adjusting the income distribution, saving the energy and protecting the environment are not prominent, etc. These problems are equally refracted to the existing local tax system. Local tax system, will also affect the functions of the overall tax system, because of its relatively old-fashioned taxation, insignificant funding functions and unreasonable structure, and so on.

After the tax reform in 1994, the government paid insufficient attention to local tax system reform. In recent years, whether VAT reform, income tax sharing reform, or consumption tax reform, are basically concerned with the central tax or central-and-local government shared tax, while the local tax system reform are attached inadequate importance. Even though the government has adjusted the local tax such as vehicle and vessel tax, urban land use tax, urban maintenance and construction tax, it is hard for these tax reforms to influence the overall situation of local public finance, and local tax reform has been carried out slowly. After the reform of replacing business tax with VAT, how to divide the central and local government financial resources reasonably and effectively is currently in a difficult position. It can be seen that taxation reform has a diversionary effect on the adjustment of tax-sharing system and the reconfiguration of the local tax system. If the taxation reform cannot be advanced scientifically and rationally, the problems centered on the tax-sharing system and the local tax system cannot be well solved.

1.4.3. It is difficult to choose the main tax category of local tax system

The choice of the main tax categories is one of the most important issues in the reconstruction of the local tax system. In the current tax structure, the only main local tax—business tax, has already been replaced by VAT and become a shared tax between the central government and local government. The problem of local governments is which taxes should be competent as the main local tax categories. Throughout the current tax structure, local exclusive tax, due to its aging problem, low elasticity of tax revenue, limited financing ability, can’t replace the business tax, and thus the choice of

main local tax categories is in dilemma. At present, the academic circles have proposed various reform schemes as to main tax categories of local tax system, such as domestic consumption tax and vehicle purchase tax, retail tax and individual income tax, real estate tax and individual income tax, and so on. A large number of opinions regarding with that shows the difficulties to choose the main local tax currently.

1.5. Tax reform is constrained by tax administration.

As a result of the tax administration constraints, the tax system tends to be simplified and the current tax system generally has the double-track system problem. Because of the complexity of object of taxation and taxation basis, tax administration bureau tends to take the simple tax management methods such as checking collection, but the tax system has also lost its original efficiency. For instance, after replacing business tax with VAT, because the original enterprises paying business tax are mostly small-scale taxpayers, and are generally applicable to the simple tax management method without VAT input tax deduction, and aren't brought into the VAT deduction chains. Although its difficulty of tax administration is reduced, the institution effect of replacing business tax with VAT is also decreased significantly.

Taking into account the constraints of tax administration, the current tax is mainly paid by corporate taxpayers or by withholding at source, few proportion of revenue is paid directly by the natural taxpayers and thus tax authorities, management systems and technologies are mainly configured based on these features. The future tax reform will gradually increase the proportion of direct tax, therefore the tax administration bureau will also be faced with a large number of natural taxpayers, which presents new challenges for the way of tax administration, institutional setting and mechanism coordination.

2. The potential solutions to the future tax reform

2.1. To adapt to the need of comprehensively deepening the reform and to promote tax reform

On the background of comprehensive deepening the reform, the future tax reform will be an overall and long-term institutional innovation. In terms of overall reform thinking, the future tax reform should be carried out with the following new items (Table 2) in order to build a modern tax system: (1) A new orientation of the goal. The new orientation of reform's target indicates the profound changes in the important parts of the tax system, the subversive shift in the focus of the tax reform, and the new adjustment of reform ideas. (2) A new transformation of the guiding ideology. The new transformation of the guiding ideology reflects the different requirements

of the tax system in different development periods and different reform tasks. (3) A new definition of the tax function. The new definition of the tax function makes a significant change in the tax system and tax regulation, which reflects a higher and more comprehensive pursuit of tax system function.

In the aspect of the system framework, transformation of tax function should be achieved from the emphasis on financing capacity to the balance of the pluralistic value; tax structure should realize the change from indirect tax as the main tax to gradual raise of the status of direct tax. In the aspect of vertical taxation system, when the conditions are ripe, it is necessary to implement the major reform from relying on the shared tax to rationalizing the revenue division relationship between the central and local governments based on tax attribution. In the aspect of tax administration, it is necessary to break through the above restrictions and to safeguard tax reform.

Table 2
The profound changes in tax reform

	Tax reform in 1994	The future tax reform
Task	To adapt itself to market-oriented economy system	To Match national governance
Target	To Establish a tax system compatible with the socialist market economy	To build a modern tax system adapting to the modernization of national governance system and governance capacity
Guiding ideology	To unify the tax law, equalize tax burdens, simplify the taxation, decentralize properly, rationalize the relations of distribution and ensure the revenue	To optimize tax structure, improve tax function, stabilize macro tax burden, promote tax administration according to law
Function	To raise revenue, adjust distribution and regulate the economy	To raise revenue, adjust distribution, and promote structural optimization

2.2. To steadily advance the tax reform and enhance the tax function

2.2.1. Co-ordinate arrangements to maintain the stability of tax burden and reduce the difficulty of tax reform

Reform of replacing business tax with VAT is conducive to optimize industrial and economic structures; consumption tax reform contributes to regulate distribution, save resources and other functions; individual income tax is helpful to adjustment income distribution; resource tax reform helps to save resources; and real estate tax reform conducts the regulation of wealth distribution and other functions. Tax items which separately decrease and increase tax burden for the current and forthcoming tax reform are decomposed, as shown in Table 3. The reform items which decrease tax burden include the reform of replacing business tax with VAT and VAT reform itself. The

reform items which increase tax burden include consumption tax reform, resource tax reform, real estate tax reform, etc. Individual income tax has both effects of the above.

Table 3

The decomposition of tax reform

	To reduce tax burden	To increase tax burden
	Reform of replacing business tax with VAT/ VAT reform itself	Consumption tax reform
Tax reform items	Individual income tax reform	
	—	Resource tax reform
	—	Real estate tax reform

In the process of taxation reform, the coordination of taxation function and taxation reform is supposed to be made, to reduce taxation reform “friction”. To improve taxation function can be accomplished through taxation reform, but mutual conflict or contradiction can easily take place in the taxation reform. At this point, tax increases and tax cuts should be coordinated to reduce the friction. The all above tax reforms are hard bones. How to promote the reform determines the overall process and effectiveness of taxation reform. A reference to be chosen is to adhere to the principle of stabilizing tax burden, to make top-level design, to reasonably co-ordinate arrangements for tax increases and tax cuts, and steadily promote reform.

In the case of the coordination between real estate tax and individual income tax, the linkage mechanism should be constructed to allow the tax burden of real estate tax to be deducted from the individual income tax base. Despite both real estate tax and individual income tax involved in the function of regulating distribution, both are related to tax increase and their convergence should be paid attention to. The current expense deduction standard items of individual income tax do not include the real estate tax burden, but real estate tax burden in the future will be the necessary expense of taxpayers and shall be deducted in the individual income tax base, which is needed to be attached importance to in the future reform. Under current conditions, it is not excluded that the tax base of individual income tax will be lower than the real estate tax burden. But whether the situation necessarily exists depends on two aspects. (1) The design of real estate tax. If the burden of real estate tax in the future is rather low, the increase of the real estate tax burden will not be obvious, and the above situation will not occur. (2) The design of expense deduction standard of individual income tax. If the real estate tax reform is accompanied by raising the expense deduction standard of individual income tax, the rise of the real estate tax burden will be offset by individual income tax.

For the reform of resource tax and consumption tax, there is a coordination relationship with the corporate income tax because the resource tax and consumption

tax can be deducted as expense items in the corporate income tax, which can reduce the friction of the taxation reform.

2.2.2. To optimize overall tax system and to enhance tax function

2.2.2.1. To focus on cultivating the relevant taxes to strengthen tax functions

The functions of taxes are based on its financing ability as a prerequisite and guarantee. Therefore, it is necessary to promote the reform of corresponding major taxes. To improve the related functions of tax system, we should focus on promoting the reform and capacity construction of corresponding major taxes. Through their corresponding reform, the environmental tax, resource tax, individual income tax and real estate tax will become into the main taxes in the areas of environmental protection, resource conservation and income distribution. To raise the financing ability and enhance corresponding main functions also helps to reduce the degree of tax dispersion.

2.2.2.2. To focus on improving the taxation function to promote social equity

In adjusting the income distribution, we should keep to a more macro and strategic perspective, with overall consideration and effectiveness as the basic requirements, in order to build a comprehensive, multi-level tax system to promote social equity. The tax system that promotes social fairness requires not only the individual income tax for income redistribution, the consumption tax for primary income distribution, but also the real estate tax, and even the property tax, on the side of the property distribution.

2.2.2.3. To regulate economic and social structure by optimizing the tax structure

In the promotion of structural optimization, the reform of tax system has great potential. Taxation serves as a mechanism for coordinating the interests between the government and the taxpayers. Whether it is the economic structure, industrial structure of the economic sectors, or the income structure of the social sectors, or the country's governance system and structure, it can be substantially affected by tax system, tax structure and the specific taxation directly or indirectly.

2.3. *To break through the problems in order to deal with the reform of direct tax and indirect tax.*

2.3.1. To consider realistic constraints and the space of reform, and gradually to optimize the proportion of direct and indirect tax

The future tax revenue growth is the guarantee of economic and social development and reform, but it is also constrained by macro tax burden. In this case, it means that

the future tax revenue should enter into the ‘new normal’ state, neither too fast nor too slow to increase, so that the macro tax burden could remain basically stable, without at the expense of reducing the tax revenue scale.

Through reform, the proportion of indirect tax will be reduced, which provides the possibility for raising the proportion of direct taxes. Replacing business tax with value-added tax (VAT) is a reform item with greatest impact on indirect taxes and with the effect of reducing tax burden. Therefore, it can decrease the proportion of indirect tax, and the reform space released by it can provide the possibility to reform direct tax.

Based on the possibility, the reform of direct tax is beset by the burden of the taxpayer, and it is difficult to gain reliable financing ability in the short term. The reform of direct tax, while obtaining a degree of government revenue, cannot effectively make up the gap brought about by indirect tax reform in the short run. Specifically, direct tax will at first make a breakthrough on the individual income tax, and on the contrary, real estate tax reform is more difficult. Therefore, the adjustment path of the future tax structure will roughly transform from the current indirect tax-based structure, first to dual structure with indirect tax and income tax, and then with maturity of the real estate tax and other taxes, to eventually form a structure with income tax and property tax as the main tax.

Further, in the case of safeguarding financial resources, the second-best plan is to improve the tax structure by upgrading the status of corporate income tax at the present stage. Corporate income tax is a direct tax levied on capital profits, which is the capital tax burden borne by corporate taxpayers. The main tax adjustment from indirect taxation to corporate income tax has the advantages as follows. First, to optimize the distribution of tax burden and make the distribution of tax burden clearer and more explicit. Second, corporate income tax can be identified as the main local tax, to solve the problem that local main tax is difficult to be chosen. Finally, its obstructions is at the minimum level in all reforms and it is easy to be implemented. As the turnover tax burden to a certain extent is the deduction of corporate income tax, there is an interrelated relationship, and thus the future turnover tax reform will directly lead to status changes of corporate income tax. In reality, it is true. The proportion of VAT has gradually declined due to its overall transition reform in 2008, but it has been replaced by the rise of corporate income tax¹ because there is a linkage between VAT and corporate income tax.²

¹ From 2010 to 2014, the proportion of VAT in the whole tax was reduced from 28.81% in 2010 to 25.89% in 2014, correspondingly, corporate income tax from 17.54% in 2010 increased to 20.67% in 2014, the two show ‘reciprocal’ relationship.

² It is reflected in the following: First, although the value-added tax is not related to the income tax, but maintenance construction tax and education surcharge with VAT as the tax basis, have effects on the corporate income tax. Secondly, if VAT is paid by small-scale taxpayers, or other situations, VAT will be unable to carry out tax deduction, and thus the expense business in the enterprise will increase, eventually affecting corporate income tax.

2.3.2. To steadily improve the reform of direct tax

Is the individual income tax reform restricted by the above institutional problems and how to resolve it? We believe that this problem needs to be treated according to the truth. (1) For income items such as earned income; salary; remuneration income, they having obvious income source place, and thus tax revenue from these items should be shared by local government of the income source place and central government, neither exclusively by central government, nor shared by local government of taxpayers' residential place. Whether the employee belongs to residential population or temporary resident population, he benefits from local public goods from local government of the income source place, so that tax levied on the income received from the income source place shall be shared with local government of the income source place. Therefore local governments which take on the task of collecting comprehensive income, are only responsible for the comprehensive assessment of taxpayers' income and types of income, to ensure its legitimacy and authenticity, and are not be involved in tax-sharing, where there is no division and transfer of tax revenue between the place of income source and the place of residence. Therefore, the difficulty of individual income tax reform mainly lies in the technical problems, such as the sharing of tax information and tax audit, between the place of income source and the place to consolidate tax revenue, which are relatively easy to be solved in the Age of Big Data. (2) For the other types of income, the best way is to implement a central exclusive system, and their revenue is not shared with the local governments.

As to the difficulties of the real estate tax reform, the key is the functional orientation of real estate tax. The real estate tax is expected to take on the task of regulating the housing price, adjusting the wealth and distribution, and acting as the local main tax category. For different functional orientations, the reform program will be different and thus to definite its functional orientation is the premise and the key. On this basis, can its legislation and reform be executed. We believe that the current real estate tax reform is to modernize the real estate tax, and in a way to fulfill the function of adjusting distribution.¹ But concerned about the burden of taxpayers, it is difficult to raise its financing ability at the present stage and assume the task of raising the status of direct tax in the short term.

¹ As a direct tax, real estate tax is able to adjust the wealth distribution by nature, but the effectiveness of the adjustment function depends on two aspects: adjustment range and design of tax rate. According to international practice, real estate tax will be implemented a unified tax rate, at the same time the effectiveness degree of adjusting the distribution, of course, is lower than in the progressive tax rate.

2.4. To deepen tax sharing system and tax reform, and to improve the local tax system

2.4.1. To improve tax sharing system, and to simplify the fiscal level in order to consolidate the basis of local tax system

To improve tax sharing system is the prerequisite to the reconstruct local tax system and to cultivate local main tax. To adapt public expenditure responsibility to all levels of authority is conducive to build a reasonable and stable fiscal relationship among government levels and form the basis of the local tax system. In addition, to simplify the fiscal level contribute to better divide the tax categories in the fiscal system under the provincial levels.

2.4.2. To deepen the tax reform, and constantly optimize the local tax system

In order to meet the needs of comprehensively deepening the reform, it is necessary to reform the local tax system in accordance with the requirements of the modern tax system. To promote local taxation reform, such as resource tax and environmental tax, will contribute to form a scientific and reasonable local tax system.

2.4.3. To establish the main tax at all governments' levels

Based on the framework of the tax system reform and other factors, different reform ideas of local main tax are determined according to short and long-term, to solve the difficulties of local main tax reform.

In the near future, the main content is to adjust and improve the current tax system. How to make up the local financial gap brought about by the reform of replacing business tax with VAT is the difficulty of the current local tax system. It is obviously impossible to make direct and effective offset through a comprehensive and difficult tax reform. It is better to make a breakthrough on the current taxation and realize the optimal tax division, such as to adjust the sharing proportion of corporate income tax, and even take corporate income tax as local exclusive tax; to continue to reform the resource tax to become the main tax in resource-based regions.

In the long term, local governments are supposed to reduce the dependence degree on shared tax and focus on the cultivation of local main tax at all levels, when tax attribution is taken into consideration. We will steadily promote the reform of real estate tax, making it the main tax of governments at city and county level; reform the urban maintenance and construction tax, making it the tax revenue of counties to improve the investment and financing system for municipal infrastructure; further reform environmental tax, which should be taken as the provincial government's main tax, in order to enrich the environmental protection funds.

2.5. To establish and improve the tax administration institution and system in order to provide guarantees for tax reform

Under the background of comprehensively deepening the reform, we should break through the restriction of tax administration so as to provide guarantee for deepening the tax reform.

2.5.1. To improve the tax administration law which lays the foundation for the tax reform

The future direct tax reform requires the tax authorities to face the natural taxpayers, which requires the corresponding adjustment of the tax administration law. For example, in the case of tax protection measures, the restriction of ‘the taxpayer engaged in production and operation’ is supposed to be abolished and the scope of taxpayers is supposed to be expanded to all taxpayers and withholding agents; in the case of tax inspection, the limitation that tax authorities can only inspect the savings accounts of taxpayers engaged in production and operation is supposed to be cancelled and modified to all bank accounts.

2.5.2. To strengthen the level of tax administration through innovations on tax administration mechanism, system and technologies

For natural taxpayers, it is necessary to establish and improve the tax administration mechanism to safeguard the tax regulation. Directed against residents’ income and property, it is necessary to establish a series of tax management system, which includes natural taxpayers’ income and housing information collection mechanism, asset evaluation mechanism and institution, tax source management system and mechanism, tax service mechanism, etc.

For corporate taxpayers, it is necessary to improve the efficiency of tax management so as to consolidate the basis of tax reform through institutional innovation. For small and medium-sized enterprises either whose financial system is not sound or which cannot build up accounting system, the tax authorities should strengthen supervision over the financial accounting and management to make it perfect gradually or encourage these taxpayers to entrust the accounting firms or certified tax agents offices to build up accounting system in order to standardize accounting management or issue relevant invoices on behalf of these enterprises. Improving these enterprises’ financial system and financial management can help to improve effectiveness of tax administration and tax system.

2.5.3. To strengthen taxation services

In order to deal with the direct taxation reform, tax administration should highlight the status of taxation service. It is necessary to adhere to the equal importance

principle on tax management and service, and provide quality, efficient, standardized and transparent modern tax services for taxpayers, actually from the perspective of taxpayers, convenience. The tax authorities should maintain the legitimate taxpayers' rights and interests in the system and methods aspects, and truly form the concept of 'serving the taxpayer'.

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