

# Research on Deepening the Reform of Individual Income Tax System under the Concept of Common Prosperity

Ji Zhu\*

Zhejiang University of Finance and Economics Dongfang College, Zhejiang, China

\*Corresponding author.

## **Abstract:**

Common prosperity is the essential requirement of socialism, and tax policy plays an indispensable role in promoting common prosperity. Although the current individual income tax system already contains some elements of "common prosperity", individual income tax still needs to be further reformed in the process of promoting common prosperity and should play a greater role in adjusting individual income distribution. In the process of realizing the goal of "limiting high-income, expanding the middle-income and improving the low-income", individual income tax should balance the contradiction between the labor income tax and the poor tax burden of capital income, strive to improve the middle-income groups included in the scope of the system, enhance tax awareness and tax compliance, strengthen personal tax anti-avoidance management by using big data, promote institutional fairness, further reduce taxes on low-income and increase additional deductions to improve the payment ability of low-income people, and play a good role in the regulation of direct taxes.

**Keywords:** *common prosperity; personal income tax; collection and management; system innovation*

---

## I. INTRODUCTION

In August 17, 2021, the country's leaders presided over the 10th meeting of the Central Financial and Economic Committee to study the solid promotion of common prosperity. He pointed out that common prosperity should be promoted in high-quality development, the relationship between efficiency and fairness should be correctly handled, and the basic institutional arrangements of primary distribution, redistribution and tertiary distribution should be established. Common prosperity calls for greater regulation and precision in taxation, social security and transfer payments, an increase in the proportion of middle-income groups, an increase in the income of low-income groups, a reasonable adjustment of high income, a ban on illegal income, and the formation of an olive-shaped distribution structure with large middle and small ends. Taxation, as an important means of the second distribution, should play a constructive role in promoting common prosperity. Direct taxation is more effective than indirect taxation in regulating the distribution of personal income. In the current environment, personal income tax plays a more important role in regulating income distribution than property tax in spite of a high voice of real

estate tax. Personal income tax in most countries in the world is progressive, which can narrow the income gap to a certain extent and can be generally accepted by taxpayers.

From the perspective of data, the financial revenue and expenditure of the first half of 2021 announced by the Ministry of Finance shows that from January to June 2021, the national tax revenue amounted to 10,046.1 billion yuan, up 22.5% year-on-year, among which personal income tax revenue amounted to 722.2 billion yuan, up 24.9% year-on-year. The proportion of personal income tax to national tax revenue was temporarily 7.19%. In 2020, the individual income tax revenue was 1156.8 billion yuan, accounting for 7.50% of the total tax revenue. Under the impact of the COVID-19 outbreak, the national tax revenue decreased by 2.3% year-on-year, while the individual income tax increased by 11.4% year-on-year, indicating that the individual income tax has a stable performance in contributing to the tax revenue. As shown in Fig. 1, it is foreseeable that in the near future, personal income tax will certainly play its wealth regulation role as a direct tax, and play a good role in the secondary and tertiary regulation of tax revenue in promoting common prosperity.

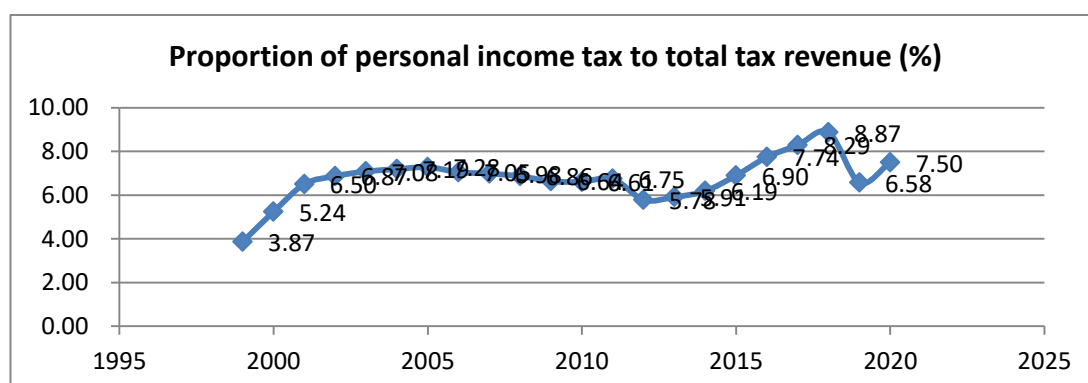


Fig. 1 Proportion of personal income tax from 1999 to 2020

From the top-level design point of view, in the *Outline of the Thirteenth Five-Year Plan for National Economic and Social Development of the People's Republic of China*, it is proposed to fully implement the statutory principle of taxation according to the requirements of optimizing the tax structure, stabilizing macro tax burden and promoting tax administration according to law, and to establish a modern tax system with scientific tax categories, optimized structure, sound laws, standardized fairness and efficient collection and management, and gradually increase the proportion of direct taxes. At the Third Plenary Session of the 18th CPC Central Committee, it was proposed to deepen the tax system reform, improve the local tax system and gradually increase the proportion of direct taxes, and gradually establish a comprehensive and classified personal income tax system. In the report of the 19th National Congress of the Communist Party of China, it was proposed to deepen the reform of the tax system and improve the local tax system. According to the *Outline of the 14th Five-Year Plan (2021-2025) for National Economic and Social Development and Vision 2035 of the People's Republic of China*, we should improve the modern tax system, improve the local direct tax system, optimize the tax structure, appropriately increase the proportion of direct tax, and deepen the reform of tax collection and management system. From the

national level, gradually increasing the proportion of direct taxes has become an important part of the top-level design, so it is particularly important to study the individual income tax system in detail.

From the perspective of academic research, Liu Kun (2020) gave a professional interpretation of "improving the direct tax system and gradually increasing the proportion of direct tax" in the article *Building a Modern Fiscal and Tax System*. Improve the direct tax system with income tax and property tax as the main body, gradually increase its proportion in tax revenue, effectively play the role of direct tax in raising fiscal revenue, regulating income distribution and stabilizing macro economy, and consolidate the foundation of social governance. Further improve the personal income tax system combining comprehensive and classified. Promote the reform and revision of personal income tax in a timely manner, reasonably expand the scope of income included in comprehensive taxation, improve special additional deductions, and improve the policy system for attracting overseas high-end talents. Establish and improve personal income and property information system. Li Xuhong and Guo Ziwei (2021) found that there are some problems in China's personal income tax, such as low income and heavy tax burden of labor income, by comparing the development trend of foreign personal income tax in recent two years, which can be solved from many aspects. First, capital income should be included in the scope of comprehensive income tax calculation, and at the same time, modern tax collection and management should be promoted to avoid tax loss, so as to increase the proportion of personal income tax to total tax revenue. Second, the tax burden of low-income groups should be further reduced by improving the special additional deduction policy to achieve tax equity. Third, preferential tax policies for high-end talents should be optimized to improve the contribution of human capital accumulation to high-quality development. Theoretically, the personal income tax system still needs to improve the policies and regulations, so as to realize the role of regulating tax income distribution.

Internationally, the Gini coefficient of major countries in the world has been continuously increasing since the end of 1970s, and income inequality has become a global problem. How to improve the structure of tax burden distribution through tax reform and seek a dynamic balance between equality and efficiency is a major practical problem that countries generally pay attention to, and is also a core proposition that runs through the overall design of tax reform and various tax reforms. According to the *2020 Tax Reform Report* released by OECD in September 2020, the individual income tax of OECD member countries accounts for 24% of the total tax revenue<sup>[1]</sup>, which indicates that there is still room for increasing the proportion of individual tax. International experience shows that the premise of making personal income tax play a greater role in regulating income distribution is that personal income tax becomes the main tax of a country<sup>[2]</sup>. At the same time, we should firmly cut off the high income obtained through various illegal ways, carry out global tax coordination, and determine a reasonable marginal tax rate for the high-income class based on international comparison, so as to condense and attract the wealth of the high-income class to stay in the country where they are located to invest and create wealth, so as to promote common prosperity. It is against this background that this paper discusses the perfect path of personal income tax to promote common prosperity.

## **II. "COMMON PROSPERITY" ELEMENT IN THE CURRENT INDIVIDUAL INCOME TAX SYSTEM**

### **2.1 Comprehensive income collection to promote horizontal equity in income distribution of middle-income groups**

One of the highlights of the current personal income tax system is to promote the comprehensive collection of labor income and adopt the collection and management system of withholding and remittance. Comprehensive collection for resident taxpayers is conducive to unifying the tax burden balance between labor income tax collection items, and also highlights the tax incentives for intellectual labor achievements. Middle-income groups are the main force of personal income tax payment, promoting horizontal fairness among members within groups, paying more attention to institutional fairness while pursuing the efficiency of collection and management, and having more positive significance for promoting social fairness and justice, so we need such a system arrangement on the road of "common prosperity".

### **2.2 Increasing special additional deductions to effectively reduce the tax burden of low-and middle-income people**

In order to further reduce the burden of low-and middle-income earners, six special additional deductions have been added to the current personal income tax system, involving items such as supporting the elderly, serious illness medical care, children's education, continuing education, rent and mortgage, etc. The middle-aged group of a normal working family usually involves 2-3 items that can be deducted. According to the monthly deduction standard of 2,000 yuan per capita, assuming that the marginal tax rate applicable to a worker's comprehensive income tax is 10%, then a total of 24,000 yuan can be deducted in one year, and a tax payment of 2,400 yuan can be reduced in one year, which is basically a month's living expenses for a family. Therefore, the perception of falling tax burden is obvious. The formulation of the special deduction policy is a tax law response to alleviate the real life burden of low-and middle-income people, reduce the tax burden of low-and middle-income people, and further improve the quality of life and happiness index.

### **2.3 Cancelling the tax incentives for year-end awards to rationally adjust the income of high-income groups**

According to the current policy, the preferential policy of tax calculation for year-end awards alone will not continue after the implementation in 2023, which is also one of the measures for the system to promote common prosperity, because the main form of income is usually not salary, but high year-end awards for high-income earners. The preferential tax policy for the year-end bonus alone is obviously unfair (usually, the marginal tax rate of the year-end bonus is lower) for the existing system of comprehensive collection of labor income, which may lead to the phenomenon of high income and low tax burden, contrary to the principle of affordability. Therefore, canceling the year-end award is of positive significance for regulating the reasonable tax payment of high-income earners, reflecting horizontal fairness and promoting social

fairness and justice.

2.4 Adding anti-tax avoidance clauses, and cracking down on tax avoidance of high-income earners to maintain the authority of tax law

In the current personal income tax law, an anti-tax avoidance clause has been added, which gives the tax authorities the right to make tax adjustment according to reasonable methods, aiming at tax avoidance behaviors such as individuals not transferring property according to the principle of independent transaction, avoiding tax in overseas tax havens, and implementing unreasonable business arrangements to obtain improper tax benefits. At the same time, the tax authorities are required to make tax adjustments that those who need to pay additional taxes should pay additional taxes and interest according to law. According to the *Opinions on Further Deepening the Reform of Tax Collection and Administration*, China's decision to control the tax avoidance of high-income people and to regulate the tax payment of high-income people is an important link in promoting social fairness.

### III. POINTS TO BE IMPROVED IN THE CURRENT INDIVIDUAL INCOME TAX SYSTEM

#### 3.1 To -be-expanded scope of collection, unbalanced tax burden between projects

According to the current personal income tax law, the incomes included in the comprehensive income tax collection range are salary income, labor remuneration income, remuneration income and royalty income, all of which are labor income. Compared with personal income tax and capital income (property transfer, property lease, dividend interest dividend income) and accidental income at present, the scope of comprehensive collection is narrow at present, which to some extent bridges the imbalance of tax burden of these four incomes, but it also opposes labor income and capital income, forming the subjective feeling that labor taxes are heavier than capital taxes. The excessively high marginal tax rates imposed on individual workers with higher incomes will force individuals to register as individual businesses or to make equity investments, which will further narrow the scope of the comprehensive income tax to cover the population and tax sources, and will be even more detrimental to the adjustment of income distribution, thus compromising the goal of common prosperity.

#### 3.2 Low personal income tax coverage of middle-income people

According to the information disclosed by China Accounting News in 2020, it is estimated that more than 80 million natural person taxpayers in China's first settlement period (2019) will have to complete such a thing that they have never done before in this four-month period, indicating that the proportion of remittance included in the consolidated income is still not high. The National Bureau of Statistics released *China Statistical Yearbook 2019* to disclose the data of income and the proportion of people in all walks of life in China. At present, 90% of people in Chinese society earn less than 5,000 yuan a month, 62% of people earn less than 2,000 yuan a month, and only 71.1 million people earn more than 10,000 yuan a month. The data released by Caixin.com (as shown in Table 1) can further support the above view. In the

income structure where low income accounts for a relatively high proportion, overemphasis on the tax reduction for low-income earners has reached the reality that some people do not pay taxes, which does not mean that the system is a good system. The adjustment function requires taxpayers to have room for adjustment within the system. The cultivation of the awareness of paying taxes is promoted through the experience of paying taxes. If the majority of workers cannot participate in the payment and settlement of individual income taxes, the recognition of individual income taxes will be reduced, which is not conducive to the further reform of the follow-up system. At least, the attention of the tax law is not enough. The income distribution effect of personal income tax in developing countries is generally low, mainly because the scale of personal income tax in developing countries is generally small<sup>[3]</sup>. The first thing to do to improve the fairness of tax revenue is to expand the coverage.

**Table 1 Distribution of monthly income population in Chinese mainland in 2019**

Income range	Population proportion
More than 5,000 yuan	72 million people
2,000- 5,000 yuan	364 million people
1,090-2,000 yuan	364 million people
Less than 1,090 yuan	0.6 billion people

Note: Data are obtained from Caixin.com. The above data are approximate numbers.

### 3.3 Insufficiently detailed provisions of the individual income tax anti-tax avoidance clauses

Three situations of tax adjustment stipulated in Article 8 of the current *Individual Income Tax Law*: (1) The business dealings between individuals and their related parties do not conform to the principle of independent transaction and reduce the tax payable by themselves or their related parties without justifiable reasons. (2) Enterprises controlled by individual residents or jointly controlled by individual residents and resident enterprises and set up in countries (regions) where the actual tax burden is obviously low, do not distribute or reduce the distribution of profits attributable to individual residents without reasonable business needs; (3) Individuals obtain improper tax benefits by implementing other arrangements that do not have reasonable commercial purposes. Practically, there are still some problems, such as unclear definition, lack of standards and weak operability. According to the estimation of relevant scholars, the amount of personal income tax loss brought by the rich immigrants in 2015 was as high as 365.2 billion yuan, equivalent to nearly half of the personal income tax income<sup>[4]</sup>. If we can't crack down on tax avoidance, tax revenue will be difficult to reflect the substance of the business and will easily cause tax exemption for low-income earners, tax payment for middle-income earners and tax avoidance for high-income earners. Therefore, we need to respond positively to tax avoidance in order to reflect the seriousness of the tax law.

### 3.4 To-be-improved special additional deduction policy

Special additional deductions are designed in the current personal income tax law, which reduces the burden of taxpayers to a certain extent. Moreover, each deduction item is an important part of the living



burden, which although is not a factual deduction but can still reduce the burden to a certain extent with a positive incentive effect in spite of insufficient strength. Under normal circumstances, a taxpayer can enjoy 2-3 deductions, which are deducted at an average of 2,500 yuan per month. Assuming that the applicable tax rate is 3%, the 75 yuan can be reduced, and the sense of gain is not strong. Besides, in terms of medical expenses, the taxpayer's husband and wife and their children are generally applicable. However, in reality, the situation with heavy medical burden is the medical burden of parents, which is not covered by the system. With taxpayers' existing health insurance, supplemental insurance and commercial health insurance, taxpayer protection is better than that for seniors. The intergenerational burden of the medical burden on the elderly makes the additional cost deduction system play a greater role, which can promote family solidarity, achieve better social value and achieve a cure for the elderly. It should have the contribution of the tax law. Furthermore, special additional deductions can play a more active role in supporting policies to encourage fertility.

#### **IV. SUGGESTIONS ON DEEPENING THE REFORM OF PERSONAL INCOME TAX SYSTEM**

4.1 Final settlement shall expand the scope of the project to balance the tax burden on labor income and capital income

Balancing the tax burden differences between individual income tax collection items, on the one hand, reduces the marginal tax rate on comprehensive income, lengthens the range of taxable income of low-and middle-income earners, and keeps the tax burden substantially the same as that of operating income, which helps to balance the realistic impulse of individual workers to register as individuals. On the other hand, it explores the establishment of a "return+ remittance" system for all items, which applies prepayment to individual income and remittance to declare all income (in the short term, the capital income items can be separately taxed, and the paid taxes are allowed to be deducted), so as to prepare for the further development of a wider range of final settlement, and actively study the design of full-scale progressive tax rate for final settlement, and balance the tax burden of labor income and capital income through progressive taxation of all income, to further realize the purpose of mediating income distribution.

4.2 Wide coverage and low tax burden should be the reform direction of personal income tax adjustment

Compared with countries with foreign direct taxes as the theme, the personal tax accounts for a relatively high proportion (see Table 2)<sup>[5]</sup>, one of the most important reasons is that the proportion of citizens covered by personal tax is very high, so the "taxpayers" are very conscious. In order to increase the proportion of individual income tax in the future, the design of the whole system is not to exempt as much as possible, but to include more people in the individual income tax system. In view of the continuity of the policy and further deepening the personal income tax reform, we can consider lengthening the 3% and 10% low tax rates to allow more taxpayers to be included in the tax system, so as to develop the habit of self-declaration, and the tax burden can be lower, but it is necessary. The enjoyment of many public services should require a tax payment certificate. If there is no payment record, it may become a restriction.

We should not reduce or exempt taxes by a large margin, but should maintain reasonable and necessary limits and strengthen individual subjective responsibilities. In this way, each group will not have a strong feeling of tax difference, and it is also beneficial to create a fair and reasonable social environment.

**TABLE 2. International comparison of personal income tax revenue in total tax revenue and GDP (2017)**

Countries	Developed countries						
	USA	Japan	Germany	UK	France	Italy	Canada
Proportion of individual tax to total tax revenue	45.4%	30.7%	43.7%	33.5%	29.2%	36.9%	41.6%
Proportion of individual tax to tGDP	10.4%	5.9%	10.2%	9.1%	8.6%	10.8%	11.7%

#### 4.3 A comparative study on the refinement of individual income tax anti-tax avoidance policies and loss compensation methods

In consideration of the fairness of the system, it is necessary to strengthen the refinement of the personal income tax anti-tax avoidance policy, use big data to accurately warn high-income earners of tax avoidance, constantly crack down on unreasonable tax avoidance or evasion at the system level, and repair and improve it from the policy level to realize tax administration according to law. After learning from the anti-tax avoidance clauses of enterprise income tax, the judgment bases and standards of "unreasonable commercial purpose" and "obviously low actual tax burden" should be clarified. Global tax coordination should be carried out to curb international tax arbitrage, reduce the cross-border flow of income and wealth for the purpose of tax avoidance, and increase the available financial resources for transfer payment in countries including China. At the same time, after the implementation of the Individual Bankruptcy Law, whether it is possible to consider establishing the method of "loss compensation" for individual income tax? The assumption of accounting going concern has become a premise and foundation of enterprise income tax collection. Whether the income earned by individuals in different periods is confirmed by stages and whether the expense deduction is changed from quantitative to factual is worthy of further discussion on its fairness. From the perspective of individual life cycle, it is more reasonable to explore the establishment of individual tax "loss compensation" system.

#### 4.4 Exploration on policy optimization of special additional deduction

There are three suggestions on special deduction and additional deduction: First, expand the deduction scope of "serious illness medical care" to immediate elders, effectively reduce the medical burden, explore double deduction, enhance the positive social effects of policies, and create a good medical care environment. Second, increase the intensity of deduction items for children's education, and respond to the social concerns of the NPC proposal. Practically, it is suggested that the data of the tax system and the health system should be linked together, and that special additional deductions for children's education should be available from the start of handling birth certificates for infants and young children, so as to extend the time limit for deduction, which is more reasonable and convenient than directly issuing



financial subsidies. Third, in the near future, the collection of personal housing property tax (the official term of "real estate tax") is the general trend, so we can learn from the experience of the US collection and management practices in the follow-up policy to explore the establishment of personal burden of the "property tax" pre-tax quota deduction policy, on the one hand to encourage everyone to actively declare the property tax, on the other hand to balance the tax burden of direct taxes.

### ACKNOWLEDGEMENT

This project is supported by Research Project of Jiaying Taxation Association in 2021.

### REFERENCES

- [1] OECD. Tax Policy Reforms 2020: OECD and Selected Partner Economies [R/OL]. (2020-09-03) [2021-01-13]. <https://doi.org/10.1787/7af51916-en>.
- [2] Ma Jun. The Road to Main Taxes: A Case Study of U.S. Federal Income Tax. Tax Research. 2020 (4).
- [3] Yue Ximing: Thoughts on Optimizing the Distribution Effect of Tax Revenue. <http://ipft.ruc.edu.cn/yjcg/sdpl/d8544284343c4770b8ea5ae3186a9404.htm>
- [4] Yuan Xinli, Huo Yanrong: Research on anti-tax avoidance of high net worth individuals in China, International Taxation, No. 5, 2020.
- [5] Liu Chenglong. Optimization of personal income tax in China from the perspective of national governance. Taxation Research .2020 (2)