

## **Structural Tax Cuts in China: Its Implementation**

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### **Abstract:**

The international financial crisis, triggered by American subprime mortgage crisis, has struck not only developed countries, but also developing countries, from which China also failed to escape and underwent many sufferings. In response to this financial crisis, the Chinese government has implemented a proactive fiscal policy and a moderately easy monetary policy, including the structural tax cuts. Through these policies, expected results have come into being. This article focuses on the analysis of the structural tax cut, explains the connotation and characteristics, describes the contents, summarizes the effectiveness, and gives a brief evaluation.

**Key Words:** International financial crisis; Structural tax cut; Proactive fiscal policy

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## I. INTRODUCTION

The ongoing international financial crisis has landed the world economy in the most difficult situation since last century's Great Depression. In the face of the financial crisis, countries and the international community have taken various measures to address it. These measures have played an important role in boosting confidence, reducing the consequences of the crisis, and forestalling a meltdown of the financial system and a deep global recession. Due to economic globalization, the current crisis has inflicted a rather big impact on China's economy. China is facing severe challenges, including notably shrinking external demand, overcapacity in some sectors, difficult business conditions for enterprises, rising unemployment in urban areas and greater downward pressure on economic growth. As a big responsible country, China has acted in an active and responsible way during this crisis. She has made timely adjustment to the direction of the macroeconomic policy, swiftly adopted a proactive fiscal policy and a moderately easy monetary policy, and issued a series of structural tax cuts policy. Currently, the policy of structural tax cuts has achieved significant results, and become a major highlight of the Chinese tax policy.

## II. THE CONNOTATION AND CHARACTERISTICS OF STRUCTURAL TAX CUTS

Obviously, the term "structural tax cuts" is composed of "structural" and "tax cuts". From the perspective of word-formation, the core of structural tax cuts is, of course, tax reduction, that is, the reduction of tax burden. However, the term "structural tax cuts" assembles "structural" and "cuts" together, which gives prefix determiners to "tax cuts", and forms structurally peculiar concepts of tax cuts. Apparently, the term "structural tax cuts" has a special meaning. According to authoritative scholars' opinion in China<sup>1</sup>, the so-called structural tax cut is a package of tax reform, which includes "increases, decreases and structural adjustment of tax". It differs not only from the comprehensive, large-scale tax cut, but also from previous increases and decreases in the tax burden adjustment. In order to achieve specific goals for specific groups, specific taxes to reduce the tax burden, the structural tax cuts emphasizes more on selective tax cut. Meanwhile, structural tax cut accentuates optimization of internal tax structure and presses close to the pace of the real economy. Furthermore, structural tax adjustment that includes both the increase and decrease of the tax burden, means that the total amount and tax base will be unchanged. However, structural tax cut focus much on tax cuts, and as a result, the overall level of tax burden is reduced. To sum up, the structural tax cut is relatively more scientific than that of structural tax adjustment. In contrast to tax cut and tax adjustment, the structural tax cut has following characteristics.<sup>2</sup>

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<sup>1</sup> Gao Peiyong, *the Structural Tax Cut: the Keynote of Tax Policy in 2009*, International Taxation in China, Vol.1, January 2009, pp5-6.

<sup>2</sup> Du Wei, *On the Structural Tax Reduction and its Effects*, Social Science Journal of University in Shanxi, Vol. 22 No. 4, April. 2010, p33.

Firstly, the structural tax cut is different from the comprehensive tax cuts. Though the structural tax cut is a kind of reduction of tax burden, it aims at specific types of taxes and bases on particular purpose. In other words, the types of taxes concerned, is selective, and not just to make no distinction for all types of taxes, but only to parts of industries or fields for tax cuts. At the same time, it also does not eliminate the possibility of raising taxes in some parts of industries. In perspective of structural tax cut, the main purpose is to stimulate consumption and investment, particularly the expansion of final consumption demand, and not primarily focuses on the general sense of the increase of total social demand.

Secondly, the structural tax cut is different from the massive tax cut. The reduction of tax burden that structural tax cut policy implemented is a small margin and low-dose. In other words, the amount of the level of tax burden is limited and not large. In the meantime, the decrease of the tax burden is controlled within a certain range, rather than uncontrolled and free breakthrough.

Thirdly, the structural tax cut is different from the structural tax adjustment. The starting point and destination of structural tax cut is the decrease of actual tax burden of taxpayers and tax revenues of the government. Its goal is to realize the decrease of the level of actual tax burden of taxpayer, rather than to convert the level of actual tax burden among different taxpayers under the condition of actual tax burden unchanged. In the end, it will realize net effect, which means the abatement of tax revenue or the proportion of tax revenue relative declined in GDP, rather than the conversion of tax revenue of different types of taxes under the condition of tax revenue or the proportion of tax revenue in GDP relatively unchanged.

### III. ANALYSIS OF THE BACKGROUND OF STRUCTURAL TAX CUTS

A. Optimizes the economic structure. In the past 30 years, china's economy has continued to grow. As a result, China's economic strength and capability of independent innovation has significantly enhanced and made great progress in the efficiency of resource and environmental protection. However, China's economic structural imbalances have also shown a worsening trend, the main problems includes lack of coordination of industrial structure, irrational structure of investment and consumption, increasing pressure of balance of payments surplus, imbalance of the development of regional and rural economic, high energy consumption and serious pollution and so on. From the relationship between tax and economic structure, as a main tool of macroeconomic control, tax plays an important role in the sustainable development of economy. Implementing structural tax cut can promote the adjustment of the industrial structure, income structure, ownership structure and regional structure.

B. Optimizes the tax structure. From the system of the types of taxes, the proportion of turnover tax is high. In 1994, China carried out tax reform, and established the system of tax division. Under this system, all types of taxes are divided into the national taxes, local taxes, and taxes shared by both the central government and local government. In other words, tax reform of 1994 has established the tax system of "double subjects". Nevertheless, in practice, the

proportion of total turnover taxes is up to about 70%, and the proportion of income tax is only about 20%. <sup>3</sup>Therefore, the tax system of "double subjects" is actually a "lame tax system." Meanwhile, there is still lack of some types of taxes in China's current tax system. For example, to date, the China's current tax system has still not established real property taxes. The current house tax and urban estate tax, although can be namely classified as property taxes, the taxpayers of both taxes does not focus on the individual taxpayer. The imperfect parts of the existing tax system, has inhibited the growth of china's investment and consumption demand, to some extent, and been not conducive to the transformation of economic structure, which is bound to affect the proactive fiscal policy. Therefore, implementing structural tax cut is the needs to optimize the existing tax system, which is conducive to optimizing the industrial structure.

C. Safeguard the social fairness and justice. Since China pursued the "opening-up" policy, it has achieved rapid economic development. However, the gap between the rich and the poor is widening gradually. In terms of comprehensive income of resident, the Gini coefficient that exceeds the warning level is an indisputable fact. The reason lies in the weakness and vacancy of the function on adjustment of the social fairness and redistribution in China's current tax. In summary, there are in three aspects: firstly, the irrational tax structure has restricted the regulatory function of tax, and intensified the tendency of inequality of income. The function that tax regulates income distribution is realized by the establishment of tax burden, tax structure, tax base and adjustment of tax rate, types of tax; secondly, the system of tax adjustment is imperfect, and every type of tax lacks of integration, which has affected the exertion of regulatory function of tax. Regulating the distribution of individual income cannot only depend on individual income tax, and should establish a perfected system of tax policy to regulate distribution of income; thirdly, the design of individual income tax system is not standard, which restricts the exertion of regulatory function of tax to some extent. To this end, a structural tax cut is conducive to maintaining social fairness and justice.

D. Cope with international financial crisis. In the face of the spread of global financial crisis, and the deep-rooted contradiction in China's economy and life, preventing economic growth down too quickly, maintaining steady and rapid economic development, has become an overriding priority. Under present circumstances, the basic way to preserve economic growth is the expansion of domestic demand. With regard to the expansion of domestic demand, the basic financial measures can be implemented, are to increase in government spending or reduce government revenue. In the light of tax cut, it can expand the disposable income of residents and enterprises thereby stimulate consumer demand and investment demand, which undoubtedly has fundamental significance. Moreover, China's tax revenue growth has been sustained for 15 years, and the tax revenue of GDP has been rapidly improved. Under this condition, tax cuts are conducive to achieve the macro-control policy of "preserve the growth, expansion of domestic demand, and the structure of the tune".

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<sup>3</sup> Gan Jiawu, *Study on Currently Structural Tax Cut*, Vol.7, July 2010, China Economist, p33.

#### IV. MAJOR MEASURES OF STRUCTURAL TAX CUT

A. the reform of unification of enterprise income tax between foreign invested enterprise and domestic enterprise<sup>4</sup> and the related preferential policies

Foreign invested enterprises (referred to as “FIE”) and domestic enterprises<sup>1</sup> were subject to different income tax regulations and tax rates in China in the past. For example, as compared with domestic enterprises, FIEs generally were eligible for a lower income tax rate and more tax deductions and exemptions. This has materially changed since January 1, 2008. On March 16, 2007, the National Peoples’ Congress in China passed Enterprise Income Tax Law of the People’s Republic of China (referred to as “EITL”), effective as of January 1, 2008. The issuance of the EITL is viewed as a milestone for the reform of China’s enterprise income tax, which will bring China’s corporate tax regime in line with international practices. Under the EITL, domestic enterprises and FIEs are now both subject to the same income tax law and subject to same tax treatment. However, The EITL is a relatively short notice (it only contains 60 articles) and only sets out a framework guiding the future evolvement of China’s enterprise income tax regime, which is too principled and lack of maneuverability. In order to implement the EITL better, On December 6, 2007, the State Council in China approved Implementing Rules of the Enterprise Income Tax Law of the People’s Republic of China (referred to as IREITL), which promulgated on December 11, 2007 and effective as of January 1, 2008. The effectiveness of the EITL and IREITL marks the establishment of a unified tax rate and corporate income tax system in China, which is conducive to promoting the competition between domestic enterprises and FIEs.

Under the current enterprise income tax system, the standard tax rate of 25% is applicable to domestic enterprises and FIEs, a preferential rate of 20% is available to certain low profit making enterprises, and a 15% rate for new and high technological enterprises<sup>5</sup>. After the enforcement of the EITL and the IREITL, to ensure the smooth implementation of the new tax law, the State Council of China has formulated a series of supporting policies. According to the tax law and policies, the Ministry of Finance of People’s Republic of China (referred to as “MOF”), State Administration of Taxation of People’s Republic of China (referred to as “SAOT”) also have issued the relevant supporting documents to in respect to tax incentives. Overall, the EITL and relevantly supporting policies regulates tax preferential policies except unifying the income tax rate between domestic enterprises and FIEs, and reducing income tax rate of domestic enterprises. The tax preferential policies are as follows:

(a) Support the development of the high and new technology enterprise. According to paragraph 2 of Article 28 of the EITL, high and new technology enterprises that require key state support are subject to the applicable enterprise income tax rate with a reduction of 15%. The EITL and the IREITL authorize the Ministry of Science and Technology (referred to as

<sup>4</sup> An enterprise incorporated under Chinese law, which has no foreign shareholders.

<sup>5</sup> See article 4 of Enterprise Income Tax Law of the People’s Republic of China.

“MOST”), the MOF, SAOT to issue detailed guidance regarding the qualifications and certification procedures for high and new technology enterprises. On April 14, 2008, and after receiving approval from the State Council of China, the MOST, MOF, and SAOT issued the Administrative Measures for Assessment of High and New Technology Enterprises and the Catalogue of High and New Technology Areas Specifically Supported by the State by way of a joint circular (Guo Ke Fa Huo [2008] No.172). Under the stipulation of circular, a high and new technology enterprise should meet the following requirements: (1) it falls within the scope of the Catalogue<sup>6</sup>; (2) it owns its core intellectual property through (i) self-R&D, transfer, donation or merger in the last 3 years or; (ii) obtaining an exclusive right to use the IP associated with the main products and/or services for a 5 year period. Enjoying exclusive right to use the IP under specified conditions may also be regarded as owning core intellectual property, which seems to demonstrate that becomes less stringent to fulfill such requirements than previously expected.; (3) it employs a minimum number of technology and R&D staff: staffs with university degree and above shall account for at least 30% of the total headcount of the enterprise, and R&D staff shall account for over 10% of the total staff of the enterprise;(4) it has a minimum percentage of R&D expenditures. The percentage of R&D expenditures shall not be less than 6% if the total revenue in the preceding year is below RMB 50 million;(5) the income from high and new tech products/services shall exceed 60% of the total annual income of the enterprise; (6)it shall comply with some specified indexes in the "Working Guideline for Recognition of high and new technology enterprises". In the meanwhile, any enterprise can enjoy the preferential tax under the new tax law only if it has evaluated in accordance with the Administrative Measures for Assessment of High and New Technology Enterprises and the Catalogue of High and New Technology Areas Specifically Supported.

(b) Spur the technological innovation and progress. According to the stipulation of the Tax Law and the Implementing Rules, any enterprise shall enjoy the following preferential policies:(1) an enterprise income tax credit in a taxable year with the credit being the amount of enterprise income tax on up to RMB 5 million of income earned by a resident enterprise from any transfer of technologies. In the case of any excess of such income over RMB 5 million, there shall be allowed a 50% enterprise income tax credit. (2) with regard to research and development expenses that incurred in the course of the development of new technologies, new products or new production techniques, if they are not capitalized as intangible assets but are charged to the income statement of the current period, a50% super-deduction that is allowable in addition to the actual expense deduction; if they are capitalized as intangible assets, cost

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<sup>6</sup> The Catalogue lists more than 200 categories of technologies, products, and services in eight large technological areas. Those areas are: electronic information technology, biological and medical technology, aviation and space technology, new materials technology, high-tech services, new energy and energy conservation technology, resources and environmental technology, and transformation of traditional sectors through high-new tech.

bases of the intangible assets equal to 150% of actual costs are allowable for amortization purposes. (3) if a venture capital enterprise invests in the shareholdings of small medium high and new technology enterprises for more than 2 years, 70% of the investment amount in small-medium high-new technology enterprises may be deducted toward the taxable income of the venture capital enterprise for the year when the two-year holding is completed. Whether the amount of the deduction is not fully utilized in that year, the unused amount is allowed to be carried forward to the following tax years. (4) fixed assets affected by accelerated development of next generation products due to advancements in technology or exposure to high tremor or high corrosion, the depreciation period may be shortened. But the shortest depreciation period shall not be less than 60% of the minimum depreciation period; where an accelerated depreciation method is applied, either the double declining balance method or the sum-of-the-years-digits method may be used.

(c) Support agriculture, forestry, animal husbandry and fisheries. On the one hand, income earned by enterprises from activities in some fields of agriculture, forestry, animal husbandry and fisheries<sup>7</sup> shall be entitled to exemption from enterprise income tax. In other words, the income tax rate is zero; on the other hand, in the case of income earned by enterprises from activities in growing flowers, crops used for beverages (such as tea, etc.) , flavor, sea and inland waters aquaculture, there shall be allowed a 50% credit against the enterprise income tax. However, if the enterprises engaging in projects of restricted or prohibited industries by the State, the income accrue from which shall not be allowed to enjoy the tax incentives.

(d) Support the investment in public infrastructure facility projects. Where the enterprises engages in major State-supported public infrastructure facility projects that listed in the “Catalogue of Enterprise Income Tax Incentives for Public Infrastructure Facility Projects”, with effect from the first year to which manufacturing or business operational revenue earned from the project is attributable, there shall be allowed a credit for the entire enterprise income tax on that income from the first to third years and a 50% credit from the fourth to sixth years.

(e) Promote ethnic autonomous. The autonomous authority of ethnic autonomous locality may decide on the reduction or exemption of the portion of enterprise income tax shared by the locality that shall be paid by enterprises of the ethnic autonomous locality. Where an autonomous prefecture or autonomous county decides on the reduction or exemption, they must report to the people’s government of province, autonomous region or municipality directly

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<sup>7</sup> Growing vegetables, grains, potatoes, oil plants, beans, cotton, ramie, sugar crops, fruits and nuts; 2. Breeding selection of new variety of agricultural products; 3. Growing Chinese medicinal herbs; 4. Cultivating and growing trees; 5. Rearing livestock and poultry; 6. Harvesting forestry products; 7. Providing services relating to agriculture, forestry, animal husbandry and fishery, such as irrigation services, preliminary processing of agricultural products, veterinarian services, promotion of agricultural technologies, agricultural machinery services and repair of agricultural machinery, etc., and 8. High seas fishing.

under the central government for approval. However, enterprises of State-restricted or State-prohibited industries located in minority autonomous areas shall not be eligible for enterprise income tax exemptions and reductions.

(f) Promote the development of eco-efficient economy. (1) In the case of income earned by enterprises from the qualifying environment protection projects, with effect from the first year to which manufacturing or business operational revenue earned from the project is attributable, there shall be allowed a credit for the entire enterprise income tax on that income from the first to third years and a 50% credit from the fourth to sixth years. (2) Where enterprises utilize resources listed in the “Enterprise Income Tax Incentive Catalogue for Comprehensive Utilization of Resources” as main raw materials to manufacture non-restricted or non-prohibited products, which meet relevant national, and industry standards. In such cases, 10% of the revenue derived from such product sales may be recognized as a deduction for enterprise income tax purposes. The main raw materials shall be utilized in a proportion to the total materials consumed not lower than the standard proportion as cited in the “Enterprise Income Tax Incentive Catalogue for Comprehensive Utilization of Resources”. (3) where enterprises purchase and actually use specialized equipment which aids in protecting the environment, conserving water or reducing energy usage, or enhancing production safety and which are listed in “Enterprise Income Tax Incentive Catalogue for Specialized Equipment in Environment Protection”, “Enterprise Income Tax Incentive Catalogue for Specialized Equipment in Water Conservation or Energy Usage Reduction”, or “Enterprise Income Tax Incentive Catalogue for Specialized Equipment in Production Safety”, a 10% of the equipment’s investment cost may be credited against the current year’s income tax payable of the enterprise. If the credit is not fully utilized, the remaining balance may be carried forward to the following five tax years. The enterprises can enjoy tax credit only if they actually purchase the equipment and put it to use by themselves. If the equipments is transferred or leased within five years from the time of purchase, the relevant tax incentives shall terminate and the enterprise shall repay the amount of tax that has been credited.

#### B. Value added tax reform and related supporting tax policies

In order to further improve China’s tax system, and actively respond to the international financial crisis, the State Council of China decided to implement the reform of Value added tax (VAT) from January 1, 2009, and revised Interim Regulations of the People’s Republic of China on Value Added Tax (referred to as “IROVAT”) on November 5, 2008. In the light of the strong correlation among the business tax, consumption tax and VAT, the State Council of China also revised Interim Regulations of the People’s Republic of China on the Business Tax referred to as “IROBT”) and Interim Regulations of the People’s Republic of China on the Consumption Tax referred to as “IROCT”). Under the authorization, the MOF and SAOT



respectively revised the Detailed Rules for the Implementation of the Provisional Regulation of the People's Republic of China on Value Added Tax, the Detailed Rules for the Implementation of the Provisional Regulation of the People's Republic of China on Consumption Tax, and the Detailed Rules for the Implementation of the Provisional Regulation of the People's Republic of China on Business Tax. The aforementioned regulations and detailed rules are effective as of January 1, 2009.

The reform aimed at a shift from the production-based value-added tax regime to a consumption-based one, which enabled Chinese enterprises to get tax deductions on spending on fixed assets. As a result, it would encourage investment and technological upgrading at Chinese companies, boost domestic demand, improve companies' competitive strength and play a positive role in helping companies to tackle the financial crisis. The major contents of the VAT transformation reform are as follows:

(a) Shift from production-based VAT to consumption-based VAT. Under the reform, the China finally will allow companies to deduct input VAT for purchased fixed assets, and if the output VAT for the period is insufficient to offset the current period's input tax for purchased fixed assets, the excess input tax amount can be carried forward to subsequent periods. Notably, the definition of "fixed assets" in the VAT regulation will not be modified in this reform. As such, the term does not include real property such as houses or buildings (which remain subject to business tax and not VAT), nor does it include personal consumption assets such as automobiles or motorcycles.

(b) Eliminate the import VAT exemption for imported equipment and machinery. The new VAT regulations eliminate the import VAT exemption on imported equipment and machinery required to be imported under contract processing, contract assembly and compensation trade. Government officials have explained that the old exemption was enacted in accordance with the old production-based VAT regulations, and since the new VAT regulation applies the consumption-based VAT, the old exemption is no longer necessary.

(c) Eliminate the import VAT exemption for encouraged FIEs. The new VAT regulations also eliminate the import VAT exemption for encouraged foreign investment enterprises (FIEs). Government officials have explained that VAT for those exempted items could still be deducted from output VAT even though the particular rule for encouraged FIEs is abolished in compliance with newly-adopted consumption-based VAT. In addition, the tax refund for the purchase of domestic equipment by encouraged FIEs has also been eliminated.

(d) Increase the export VAT refund rate. To ease the current economic pressure on Chinese companies in labor intensive and highly competitive industries, the MOF and the SAT have jointly issued two Circulars, Caishui [2008] No. 138 and Caishui [2008] No.144, respectively on October 21 2008 and November 17 2008, to increase export VAT refund rates for certain textile, apparel, toy, ceramic, plastic, furniture and other products. The export VAT refund rates

textile, apparel and toys increased from 13% to 14%; while other increases were from 5% to nine or 11%, and from 11% to 13%.

(e) Modify several VAT rates. Under the old VAT regulations, small and medium-sized businesses considered small-scale taxpayers were levied at 6 percent for industrial firms and 4 percent for commercial companies. Upon the reform, the VAT rate for all small-scale taxpayers shall be reduced to a universal flat rate of 3%. The VAT rate for mineral products will rise back to 17% from 13%.

(f) Eliminate the deduction from income subject to withholding tax of business tax paid. Before the implementation of the new enterprise income tax law, business tax paid was deductible in calculating the withholding tax derived by a non-resident enterprise, in accordance with Caishui [1998]No. 59.

### C. the reform of taxes and fees on refined oil products

In order to promote the conservation of energy, reduce of emissions and reconstruction of economy, on December 18, 2008, the State Council of China calculate the Circular of the State Council on Carrying out the Reform of Refined Oil Prices and the Taxes and Fees ( Guo Fa [2008] No. 37 ), effective as of on January 1, 2009. The reform shall be of great and profound significance for regulating the fee charging pattern followed by the government, balancing social burdens, promoting energy saving and emission deduction and structural readjustment, raising funds for the maintenance and construction of transportation infrastructure in accordance with the law, and promoting a steady and healthy development of the transportation system.

The main policy of the reform is to enhance consumption tax rate of oil product, do not recreated fuel tax, and utilize the existing tax policies, tax collection method, and means of tax administration to realize effective cohesion of the relevant matters related to product oil price and tax reform. The main contents are as follows:

(a) Abolish road maintenance fees and other fees. Six charges shall be abolished, i.e., road maintenance fees, waterway conservation fees, road transport management fees, road passenger and freight surcharges, water transportation management fees, water passenger and freight surcharges.

(b) Abolish toll fees for second-class roads constructed with government loans in a gradual and orderly way. The relevant implementing plans and central government's support policies on subsidies shall be formulated as soon as possible. The people's government of each province, autonomous region, and municipality directly under the central government shall, according to the relevant plans and policies, make an overall analysis, and abolish toll fees charged for second-class roads constructed with government loans in a gradual and orderly way. Each province may abolish the fee charging policies in a uniform way, or abolish the same by steps according to their respective actual situation. The implementing plans shall be formulated by

the National Development and Reform Commission in collaboration with the Ministry of Transport and the Ministry of Finance, and may be implemented after being submitted to the State Council for approval.

(c) Mark up consumption tax rate of product oil. Gasoline consumption tax shall be increased by 0.8 yuan per liter, and 0.7 yuan per liter in the case of diesel. Consumption tax for other product oils shall be raised correspondingly. The new consumption tax rate for gasoline, naphtha, solvents, and lubricants shall be 1 yuan per liter, and that for diesel, fuel oil, and aviation kerosene shall be 0.8 yuan per liter.

(d) Taxation authority, tax collection process, tax calculation and collection methods. The consumption tax of product oil is central tax, and shall be levied and collected by the SAOT in a uniform way (the Customs shall continue to be entrusted to collect relevant tax incurred during the importing process). Taxpayers are organizations or individuals that produce, process under entrustment, or import product oil within the territory of China. The manufacturing process (including entrustment processing and importing process) shall be the process subject to paying taxes. Taxes shall be calculated according to the amount of oil consumed and shall be incorporated in the oil price.

(e) Policies on consumption tax for product oils of special purposes. After the consumption tax rate of product oil is raised, collection of consumption tax of imported naphtha shall resume. Before December 31, 2010, domestic naphtha used as raw material of ethylene and aromatics shall be exempted from consumption tax. Consumption taxes collected from imported naphtha used as raw material of ethylene and aromatics shall be refunded. Aviation kerosene shall be exempted from consumption tax for the time being. Consumption tax shall be exemptible with respect to ethanol gasoline produced from already-taxed gasoline recovered through external purchase or entrusted processing. With regard to ethanol gasoline produced from domestic gasoline, tax declaration shall be made according to the amount of gasoline consumed for producing ethanol gasoline. With regard to gasoline and diesel recovered through external purchase or entrusted processing and used for producing methanol gasoline or bio diesel, the already paid consumption tax for the raw material shall be deducted from the taxable amount of consumption tax.

(f) Distribution of new tax revenues. The consumption tax of new product oil, together with value added tax, urban maintenance construction tax, education surcharges that have increased in corresponding rate, shall be of special use. They are not recurring fiscal revenue and shall not be incorporated in the calculation base of items for which revenue is linked to expenditure. Except for the portion arranged by the Central Government to replace waterway conservation fees, the rest shall all be allocated to local finance by the financial department of the Central Government through standard finance transfer and payment. After the reform, the nature of

transportation fund, purpose of funds, local budget procedure, powers or authorities of local government shall remain unchanged.

In addition, the State Council of China has defined the relevant supporting measures to ensure smooth implementation of the reform. Firstly, improve the mechanism for giving subsidies to grain producers, and certain people or public welfare industries in real difficulty. (1) Grain producers. Farmers' increased expenditure for growing grains due to the price change of product oil in the then-current year shall be included in the scope of policies of general direct subsidies for purchasing agricultural supplies and shall be entitled to subsidies. General direct subsidies to grain producers may only be subject to increase instead of decrease. (2) Urban public transportation, rural road passenger transport (including cross-island and rural waterway passenger transport), forestry, fishery (including offshore fishery). Increase in the cost of the previously mentioned industries due to adjustment of product oil prices shall be entitled to subsidies by the central financial department through special transfer and payment method. The prevailing policies shall apply with regard to the proportion of subsidies, and the standards of subsidies shall be subject to increase or decrease according to the rise or fall of product oil prices. The Ministry of Finance in collaboration with other relevant departments shall formulate the specific measures on subsidies separately, and new measures on subsidies shall become effective from the year 2009. (3) Taxies. Before taxi rates are adjusted, increase in cost due to oil price rise shall be entitled to temporary subsidies by the financial department of the government. (4) Low-income people. Each local area shall, by taking into consideration price adjustment of product oil or liquefied petroleum gas, etc., and price changes in the market, and other factors, guarantee basic cost of living allowances for low income people in both urban and rural areas. Secondly, properly resettle personnel collecting transport related fees. (2) Acceptance by the taxation department; and (3) Replacement of personnel involved in the reform through multiple channels by local people's governments. Thirdly, Strengthen supervision and administration of product oil market. Monitoring, supervision, and administration of oil market shall be strengthened. Acts of making invoices without actual goods delivery for the purpose of evading taxes, or acts of abnormal sale of product oil by product oil manufacturing enterprises shall be forbidden, oil smuggling, operating counterfeited or inferior oil products, contract frauds, or other illegal acts shall be severely punished, to ensure a steady product oil market.

D. Mitigates export refund rate. In response to the world economic downturn, China has adjusted the export refund rate seven times since the second half of 2008. From August 1, 2008, the export refund rate of certain textile and garment was increased from 11% to 13%, and the tax refund rate of certain bamboo products was further increased to 11%. On October 2008, the export rate of certain textile and garment was increased to 14%, and the tax refund rate of toys, household and artistic ceramics, plastic products, furniture and other labor-intensive goods was adjusted respectively. On November 2008, the export refund rates of bags, shoes, hats, umbrellas, furniture, bedding, lamps, clocks and other labor-intensive products was increased to

13%, and the tax refund rate of glassware was increased to 11%. From January 1, 2009, the export refund rate of certain mechanical and electrical products was increased. For example, the export refund rate of Aviation inertial navigation systems, gyroscopes, ion ray detectors, nuclear reactors, industrial robots and other products was increased from 13%, 14% to 17%, and the tax refund rate of motorcycles, sewing machines, electric conductors was increased from 11%, 13% to 14%. From February 1, 2009, the export refund rate of certain textiles and clothing was increased to 15%. From April 1, 2009, the export refund rate of certain textile and garment was increased to 16%. On June 3, 2009, the MOFO and SAOT, accord to the spirit of the 66th meeting of the State Council of China, jointly issued Notice on further Increase of Export Refund Rate of Certain Products. According the Notice, the export refund rate of more than 2600 kinds of goods was increased, and the tax rebate money was expected to increase 25.2 billion. The seven times' adjustment of the export refund rate made 1971 kinds of export goods realize total refund. At present, the combined average tax rate of China is 13.1%, excluding the "two high" products; combined average tax rate is about 14.6%, which is close to 15% of Asian financial crisis in 1997.

E. Cancel or terminate certain administrative charges. With a view to facilitating the reform of administrative fees, promoting administration in accordance with the law, and supporting steady, progressive and rapid economic growth, the MOF and NDRC jointly issued the Notice of Cancellation and Termination of one Hundred Administrative Charges on November 13, 2008. According to the Notice, 100 administrative charges had been cancelled or terminated on a nationwide basis from January 1, 2009, which would be conducive to exerting the effects of tax cut. As a result, it estimated that reduction of the total amount of administrative charges was about 190 million.<sup>8</sup>

F. Promotes sustainable development. In recent years, China has implemented polices of sustainable development, and utilized the tool of tax to achieve the goal. China has standardized and improved the VAT to promote the comprehensive utilization of resources and energy resources, and increased the VAT rate of mineral products from 13% to 17%. In addition, with a view to limiting the consumption of alcohol and tobacco products, protecting the environment, and improving people's health, China increased the rate of consumption tax on tobacco and alcohol from May 1, 2009 and August 1 subsequently.

G. Enhance the purchasing power. In recent years, the tax threshold of individual income has increased from 800 yuan per month to 2,000 yuan per month. At the same time, the State Council of China decided to suspend to levy the individual income tax on interest earnings from savings from October 9, 2008 to increase the disposable income for residents. In addition, China carried out actively policy of auto stimulus. Under the authorization of State Council of China, the MOF and SAOT has jointly issued the Notice of Taxation on the Reduction of

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<sup>8</sup> Ministry of Finance of China, China will Cancel 100 Administrative Charge Valued RMB 190 Million, November 19, 2008, Available at: <http://stock.hexun.com/2008-11-19/111410149.html>.

Vehicle Purchase Tax on Passenger Cars with 1.6L or under Delivery Capacity (Cai Shui [2009]No. 12) , to reduce 5% vehicle purchase tax on passenger cars with 1.6L or under delivery capacity from January 20, 2009 to December 31,2009. with a view to implementing the policy of stimulating domestic demand continually , the Ministry of Finance of the People's Republic of China and the State Administration of Taxation jointly issued the Notice of Reduction of Vehicle Purchase Tax on Passenger Cars with 1.6L or under Delivery Capacity (Cai Shui [2009]No. 154) on December 12,2009 , to extend stimulus measures in the automobile industry for one more year, and increase the tax on vehicle purchases to 7.5 percent, which will be effective from January 1 to the end of 2010.

H. Promotes the development of real estate. Housing is one of the most important issues that people concerned. Housing transaction costs directly affects housing prices and population burden. To reduce transaction costs and promote the healthy development of the real estate market, China offers active tax support to low-rent housing, economically affordable housing and individually rental housing. At the same time, China decided to lower the deed tax rate of temporary property to 1% for first-time individuals purchasing ordinary housing at a maximum of 90 square meters, and temporarily exempt stamp tax and increment tax on land value for individual's sales or purchase of ordinary housing from November 1, 2008. In addition, in order to follow the guiding principles of further encouraging ordinary commodity housing consumption and promote the healthy development of the real estate market, the MOF and SAOT jointly issued the Notice of the Ministry of Finance and the State Administration of Taxation on the Policies for Business Tax on Transfer of Personal Houses(Cai Shui [2008] No.174). Under the Notice, from January 1 to December 31, 2009, with regard to a non-ordinary housing owned by an individual for less than two years since the purchase, full business tax should be levied in the case of sale of the said housing; with regard to a non-ordinary housing owned by an individual for not less than two years since the purchase or an ordinary housing owned by a individual for less than two years since the purchase, business tax shall be levied based on the difference between the income for the sale and the price for purchasing the housing; with regard to an ordinary housing owned by an individual for not less than two years since the purchase, business tax should be exempted in the case of sale of the said housing.<sup>9</sup>

I. Supports stable capital market. In order to sustain the stability of equities market, under the authorization of the State Council of China, the Ministry of Finance and the State Administration of Taxation decided to decrease the stamp tax on stock purchase from 3 % to 1% from April 24,2008, and the collection methods of stamp tax on Securities (Stock) Transaction as of September 19, 2008, which had been adjusted, i.e., both parties who sign the documentation of transfer of the equity of A and B shares for dealing in, inheriting, or gifting

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<sup>9</sup> The Notice of the Ministry of Finance and the State Administration of Taxation on the Policies for Business Tax on Transfer of Personal Houses (Cai Shui [2008] No.174) has been nullified by the Notice Regarding Adjusting the Business Tax Policies on Transfer of Individual Housing promulgated on December 22, 2009.

shall pay the stamp tax at the rate of 1%, into the unilateral tax collection method. After the adjustment, the tax burden of the stamp tax on securities transactions per time has been reduced 84.3%. At the same time, the deduction of the business tax related to stock investors' protection fund and futures investors' protection fund has increased, and the deduction standards the ratio of enterprise income tax has raised. In addition, China has further improved the restructuring of the enterprise income tax, deed tax and stamp duty tax policy that would promote the reorganization and restructuring of enterprises.

G. Enlarge employment and reemployment. Employment is vital to people's livelihood. In recent years, the China has been dedicated to solving the problem of employment, and formulated preferential tax policy not only for reemployment of laid-off workers, but also for the disabled, graduates, dependents, job-transfer veterans. With a view to the preferential tax policy, China has adjusted many times, further broadened preferential range, and reduced the threshold of tax reductions or exemptions. According to statistics, by the end of 2008, there was about 680 million laid-off workers enjoy various preferential tax policies of reemployment, and the cumulative tax reductions or exemptions was about 157 million yuan<sup>10</sup>. To promote the reemployment of laid-off workers, the MOF and SAOT, on March 3, 2009, jointly issued the Notice of Extending Tax Policy Related to Reemployment of Laid-off Workers, to extend the incentives to December 31, 2009. Under the notice, laid-off workers who engaged in individual businesses or enterprises absorbed laid-off workers would enjoy the preferential policies in the aspect of business tax, urban maintenance and construction tax and extra charges of education funds. At present, the situation of China's employment maintains overall stability.

## V. EFFECTIVENESS OF STRUCTURAL TAX CUT

A. Promote development and recovery of economy. China carried out a proactive fiscal policy and a moderately easy monetary policy, in which structural tax cut is one of the most important measures. Under the influence of structural tax cut, the tax burden of enterprises was decreased and the income of enterprises was increased, which enhanced the competitiveness of the enterprises, promoted the development of the enterprise and economic recovery. According to incompletely statistics, the structural tax cut of China has alleviated tax burden of enterprises and citizen approximately 2800 million only in the second half of 2008; in 2009, China implemented the reform of VAT, which reduced the tax about 5500 million yuan for enterprise and resident. As a result, China's economy continued to maintain steady and rapid growth,

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<sup>10</sup> Xinhua Agency, Tax Incentives of Reemployment Benefits 680 million Laid-off Workers, March 31, 2009, Available at: [http://www.gov.cn/fwxx/sh/2009-03/31/content\\_1272971.htm](http://www.gov.cn/fwxx/sh/2009-03/31/content_1272971.htm).

GDP topped 30 trillion yuan in 2008, an increase of 9% over the year of 2007<sup>11</sup>, and GDP reached 33.5 trillion yuan in 2009, an increase of 8.7% over the year of 2008<sup>12</sup>.

B. Promote the technological innovation and industrial upgrading. The transition of production-based VAT to consumption-based VAT has eliminated the contradictions of double taxation and uneven tax burden. At the same time, the consumption-based VAT allows general VAT payers to recover input VAT incurred on the purchase of certain fixed assets, which would encourage investment and technological upgrading at Chinese companies, boost domestic demand, improve companies' competitive strength and play a positive role in helping companies to tackle the financial crisis.

C. Stimulate the expansion of domestic demand and foreign trade. The structural tax cut to encourage consumption covered more areas, were stronger and benefited more people than ever before. The central government of China provided 45 billion yuan in subsidies for rural residents to purchase home appliances and motor vehicles, including motorbikes. Part of the subsidies also supported trading-in old motor vehicles and home appliances for new ones and purchasing agricultural machinery and tools. Halved the purchase tax on small-displacement automobiles, reduced or exempted taxes on buying and selling homes to support the purchase of homes to be used as their owners' residences. Throughout the year, 13.64 million motor vehicles were sold, an increase of 46.2%; commodity-housing sales amounted to 937 million square meters, up 42.1%; and total retail sales of consumer goods increased 16.9% in real terms<sup>13</sup>. In addition, China adjusted the tax refund rate, comprehensively carried out tax policies to encourage imports and exports, which expanded overseas market demand, and boosted the transformation and upgrade of foreign trade structure and exported product. As a result, since the second half of the year 2009, falls in imports and exports have clearly eased, and consolidated our share of international markets. The imports and exports totaled \$2.2 trillion in 2009.<sup>14</sup>

D. Safeguard the requirements of the national financial resources effectively. The structural tax cuts, on one hand, stimulated economic recovery; on the other hand expanded its tax base, and promoted the gradual growth of tax and fiscal revenue. Since the year of 2008, China's tax revenue appeared the change of V-shaped curve. Compared with the same period of 2007, the first quarter of 2008, the growth of tax revenue was 35.5%, second quarter was 31.9%, the third

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<sup>11</sup> National Bureau of Statistics of China, National Economy in 2008: Stable and Fast, January 22, 2009, Available at: [http://www.stats.gov.cn/was40/gjtjj\\_detail.jsp?searchword=%BD%F8%B3%F6%BF%DA%D7%DC%B6%EE&channelid=6697&record=145](http://www.stats.gov.cn/was40/gjtjj_detail.jsp?searchword=%BD%F8%B3%F6%BF%DA%D7%DC%B6%EE&channelid=6697&record=145).

<sup>12</sup> National Bureau of Statistics of China, National Economy Rise Up Well in 2009, January 21, 2010, Available at: [http://www.stats.gov.cn/was40/gjtjj\\_detail.jsp?searchword=%BD%F8%B3%F6%BF%DA%D7%DC%B6%EE&channelid=6697&record=48](http://www.stats.gov.cn/was40/gjtjj_detail.jsp?searchword=%BD%F8%B3%F6%BF%DA%D7%DC%B6%EE&channelid=6697&record=48).

<sup>13</sup> Si Gui, Structural Tax Cut: Review and Forward, Vol.2, Febury 2010, China Taxation, p 6.

<sup>14</sup> National Bureau of Statistics of China, National Economy Rise Up Well in 2009, January 21, 2010, Available at: [http://www.stats.gov.cn/was40/gjtjj\\_detail.jsp?searchword=%BD%F8%B3%F6%BF%DA%D7%DC%B6%EE&channelid=6697&record=48](http://www.stats.gov.cn/was40/gjtjj_detail.jsp?searchword=%BD%F8%B3%F6%BF%DA%D7%DC%B6%EE&channelid=6697&record=48).



quarter was 10.7%, and the fourth quarter was -4.9%. In the first quarter of 2009, the growth of tax revenue was -10.3%, second quarter was -2.4%, the third quarter was 22.6%.<sup>15</sup> The fluctuation of fiscal revenue was also similar, which indicated that China's economy had moved in the direction of stable growth. According to statistics, in 2009, China's fiscal revenue reached 6.85 trillion yuan, up 11.7%.<sup>16</sup>

E. Promote the employment and reemployment. China's small and medium enterprises are mostly labor-intensive. To promote the development of small and medium enterprises is not only beneficial to satisfy the needs of human life, but increase employment and maintain social stability and prosperity. EIL gives tax preferential rate to small and medium enterprises, and the reform of VAT decreases the tax burden of small-scale taxpayer, which promotes the development of small enterprises, increases employment, reduces social conflicts, expands domestic demand, and boosts economic development. According to statistics, a total of 11.02 million urban jobs were created in 2009.<sup>17</sup>

F. Promote energy conservation and emission reduction. The structural tax cut gives more tax incentives to the products of environmental protection and energy saving, which encourages enterprises to adopt effective measures to comprehensive utilization of resources. As a result, it is beneficial to conserving energy, reducing emissions, protecting the environment, transforming mode of economic growth. In the end, it will boost harmonious and sustainable development of economy and society. According to statistics, over the first four years of the Eleventh Five-Year Plan period, energy consumption per unit of GDP fell 14.38% and chemical oxygen demand and sulfur dioxide emissions decreased 9.66% and 13.14% respectively.<sup>18</sup>

## VI. BRIEF EVALUATION OF STRUCTURAL TAX CUT

Owing to the difference in the impacts of financial crisis, country's basic condition, economic structure, the starting point, purpose, method and pursuant results of tax cut vary from country to country. Hence, evaluating the structural tax cut should not separate from China's reality. As a rule, tax cut is not only an economic measure, but also reform of system. As far as China is concerned, the structural tax cut provides both opportunity and challenge.

A. From the perspective of macroeconomic regulation, the structural tax cut is an important step to implement the scientific outlook on development. In the short term, the adjustment of fiscal policy and other measures of macro-control, to some extent, has played an important role

<sup>15</sup> Yang Weihua, Study on Perfection on the Policy of Structural Tax Cut, Vol.1, January 2010, International Taxation in China, p 15.

<sup>16</sup> Ministry of Finance of People Republic of China, Chins' Fiscal Revenue Realize the Growth in Double-digit in 2009, January 10, 2010, Available at: [http://news.xinhuanet.com/fortune/2010-01/10/content\\_12786329.htm](http://news.xinhuanet.com/fortune/2010-01/10/content_12786329.htm).

<sup>17</sup> See, Wen Jiabao, Report on the Work of the Government --Delivered at the Third Session of the Eleventh National People's Congress, on March 5, 2010.

<sup>18</sup> Ibid.

in stabilizing the economy, stimulating domestic demand. In the long run, the structural tax cut would solve the prominent issues of structural contradictions that arises in china's long-term economic and social development, that is, economic growth is much dependent on investment and exports, the proportion of consumption in GDP declined. The scientific outlook on development requires the shifts in mode of economic growth, which means China should adopt an enlightened approach to development that results in expanded production, a better life and sound ecological and environmental conditions. To the end, China could achieve the goal to build a resource-conserving and environment-friendly society that coordinates growth rate with the economic structure, quality and efficiency, and harmonizes economic growth with the population, resources and the environment. Hence, the structural tax cut a major step to achieve this transformation.

B. From the perspective of the economic base, the structural tax cut is best way to improve people's livelihood. In terms of the structural tax cut, primarily, is tax cut, which reduces the financial burden of enterprises and residents, and increases their income. As a result, all people welcome it at any time. From the standpoint of the government, it should not merely pursue the growth GDP, but pay more attention to people's well-being and happiness index, improvement of living conditions, and increase of national welfare. As a rule, the government should implement two public functions: one is to provide the public goods and services in education, health care, social security, cultural consumption, etc; the other is to increase the disposable income of residents, avoid the actual reduction of income due to the reasons of rising prices and recession. Large-scale tax cut has always been regarded as the embodiment of stable and harmonious national, which is the direct impetus to realize richness of people. Generally, the structural tax cut is to carry out the fundamental purpose of put people first, and improve people's living standards significantly.

C. From the perspective of the superstructure, the implementation of structural tax cut provides an opportunity to reform our tax system. Just as its name implies, the structural tax cut cannot be simply interpreted as to reduce the existing tax concessions; it includes both reduce and increase tax based on the mitigation of overall taxation. As a rule, it should utilize the tax incentive to adjust economic structure, improve people's lives, cultivate new economic growth points, and promote the employment, which is the reform of the existing tax system and the corresponding financial system. With a view to perfecting the system between central government and local government, it is urgent to accelerate the process of tax reform. Under the structural tax cut, China adopted a series of measures to improve tax system in the last two years, which is conducive to perfecting market economy with Chinese characteristics.

D. the structural tax cut should match with the leverages of financial, monetary, exchange rate and price. After tax cuts, a corresponding result is the reduction of fiscal revenue in the short term. In order to optimize the structure of fiscal expenditure, ensure the funds of key projects and construction, the financial policy must change accordingly. Therefore, currency, exchange rates, and price policy adjustment is also a matter of course. At present, China adopted a

proactive fiscal policy and a moderately easy monetary policy. In the other words, China made full use of all kinds of macroeconomic regulation and control tools to respond international financial crisis besides the structural tax cut. Under the market economy, the tool of tax is not almighty. Hence, only the structural tax cut cooperate with other tools can achieve the purpose of macro regulation.

## VII. CONCLUSION

The global financial crisis in 2008 is undoubtedly the direct cause of the structural tax cut. Overall, the structural tax cut is one of macro regulatory policies to cope with financial crisis, which the largest and most extensive and the strongest tax policy adjustment since tax reform of 1994 in China. In practice, the structural tax cut has the characteristics of application of multiple types of tax, development of multiple means and promotion of multiple links, which has played an important role in promoting rapid and stable development of the economy.