

Chinese Current Special Deductible Expense of Children's Education for Individual Income Tax: International Comparisons and Helpful Suggestions

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Abstract: On December 21st, 2018, China's State Administration of Taxation issued the Operational Measures for Additional Special Deductions for Individual Income Tax (IIT) (For Trial Implementation), which added six special tax deductions for the expenses for children's education, expenses for continuing education, medical expenses for serious diseases, mortgage interest, house rent and elderly care expenses. For the first time, The IIT attached several livelihood expenditures to tax deductions. The paper cites the special deduction of children's education in current Chinese IIT law, and finds several limitations of the tax policy among the applicable conditions, the deductible standards and the true declaration. Moreover, by referencing and comparing with the IIT law and children's educational tax deductions from a few developed countries, the paper proposes relevant recommendations to improve Children's Educational deductibles.

It had been the seventh time that The State Council amended the Individual Income Tax law by August 31st, 2018. For the first time, a number of changes was significantly noticed by the general public, which adapted the classified comprehensive individual income tax collection system, set the six special tax deductions, enlarged the tax brackets on the low and medium taxable income and increased in the IIT threshold amount. The purpose of IIT reform is to adjust the wealth gap, stimulate consumption, improve the taxation system and implement the tax and fee cuts from Chinese central government. This reform reflects the governmental concern for taxpayers from the working class and offers the tax cuts for the "sandwich generation". According to the news, by the first half of 2019, the accumulated amount of the tax cut added up to RMB 307.7 billion, and 115 million Chinese did not need to pay for the personal income tax. Therefore, the amendment of IIT has significantly decreased the taxpayers' tax burden and eased the income inequality to some extent. However, the Operational Measures for Additional Special Deductions still have many rooms for improvement. This paper cites the special tax deduction in children's education, analyzes it in detail and makes several suggestions for optimizing the policy.

1. Overview of the special tax deduction on children's education

The following tax laws are cited by (State Council, 2018) and (Instrumentalities of the State Council, 2018)[1,3]

1.1 Applicable Conditions

Expenses for full-time academic education of a taxpayer's child shall be deducted. Academic education includes pre-school education for children from the age of three to the month before he or she attends a primary school, compulsory education (primary school and junior middle-school education), senior high school education (general senior secondary school, and secondary vocational education) and higher education (junior college, undergraduate, postgraduate and doctoral education).

1.2 Amount and Standard of Allowable Deduction

Expenses for full-time academic education of a taxpayer's child shall be deducted to the extent

of RMB 1,000 per month for each child. The parents may choose to deduct by either parent 100% of the allowable additional special deduction for children's education, or deduct it as per 50% of the deduction standard for the father and mother, respectively. The specific deduction method may not be changed within one taxable year.

1.3 Eligibility for Deduction

“Parents” refers to biological parents, stepparents and adoptive parents. Any person other than parents acts as the guardian of a minor.

1.4 Supporting documents

Where the child or children of a taxpayer receives education overseas, the taxpayer shall retain relevant proofs and materials for future reference, such as admission letter of an overseas school and a student visa.

2. Problems and Suggestions on the specific additional deduction’s policy on Children's Education

2.1 The applicable conditions of the special deduction

The act doesn’t consider the needs for education and care of 0-3 years old babies. First of all, in terms of the infrastructural level, China does not build enough educational institutions such as public nurseries for 0-3 years old babies whose parents are full-time workers and grandparents are not retired. The phenomenon of “nowhere to be nurtured” for kids is quite serious. The paper takes Shanghai as an example; nowadays a total of 16,200 two-three years old babies have the children’s care services in Shanghai. The amounts of kindergartens which provide day-care services are very limited. Only 22% of these kindergartens, which mostly are private-owned, have nursery classes. Secondly, with regard to the legal level, the definition of pre-school education in the Chinese educational law is 3 years old to the years to entry an elementary school, and 0-3 years babies are set the nurturing stage. Therefore, the educational and care expenditure for these kids are excluded in the income tax deduction. Thirdly, in terms of the economic level, as the price of nannies and early childhood educational schools is rising, the expenditures of taking care of a 0-3 years old baby have exceeded the financial burden of average income workers. For example, the cost of infant formula milk, diapers, toys and early educational books give large financial pressure to the families who are raising babies. Fourthly, with regard to the nurturing level of sick or disabled kids, and we take autism tendency kids as an example. Parents will spend more than average amount of money for the disabled kids in the early childhood education.

Educational subsidies and child care tax deductible system from developed countries can be used for references. In Canada, Canadian government gives welfare grants in the educational savings, and working parents can claim child-care expenses for income tax deduction. Firstly, the Registered Education Savings Plan (RESP) is a savings account for depositing money in kids’ future education. RESP is a deferred tax liability. Parents don't need to pay taxes on the value-added amount like (capital gains or dividends) as they hold the account, but their kids will pay taxes on the gains when they withdraw the savings for receiving a higher education in the future. If kids won’t go to school, they should return the government contribution part. Moreover, the government contributes maximum \$500 per year to the savings account, and maximum \$7,200 subsidies for the life time. Secondly, in order to reduce the tax burden for a working family with kids, Canadian government makes child-care expenses as tax deductible amounts which are \$8,000 annually per child under 7, \$5,000 annually per child between 7 to 16 and \$11,000 annually for disabled and dependent children. The caregivers or institutions which provide the tax deductible child-care services are like babysitters, daycare centers, educational institutions or day camps that provide childcare services, boarding schools and so on.

Therefore, in the applicable conditions of the children’s education tax deduction, the article, which combines Canadian tax system and Chinese real-life situation, gives several suggestions in

the policy. To start with the legal level, the definition of pre-school education could be expanded, and the paper suggests that a kid who ages from 0 year old to the years entrance elementary school could be defined as the pre-school educational stage. Secondly, the article suggests that the nurturing expenses of 0-3 years old babies are included in the special tax deduction for children's education. Thirdly, the paper suggests creating an educational savings account in China to reduce parents' financial pressure in their children's educational expenditure; Chinese government provides welfare grants from the public finance to the savings account for parents who are willing to save money for kids' future education after the birth of their babies. Moreover, the paper recommends educational expenditures like tuition or the educational savings account are fully income tax deductibles to reduce parents' income tax. Finally, by considering differences in babies' condition, the paper proposes that law makers set more personal income tax deductible amount to parents with disabled kids for fairly considering the parental care expenses of their misfortunate babies. These suggestions could improve the existing income tax deductible standards of children's education and reduce the burden of taxation for taxpayers.

2.2 Amount and Standard of Allowable Deduction

The additional special tax deduction does not take into account the inflation adjustments. The deductible policy is based on the fixed amount of 1,000 RMB per child per month. If the tax deductible amount remains unchanged after the cost of living increases annually, taxpayers will be subject to an invisible increase in the tax burden.

From 2012 to 2017, the Chinese residential educational consumer price index is shown in Table 1, its data comes from the China's economic and social big-data research platform. From the table, it shows that the educational expenditures in China are increasing gradually in recent years. The educational expenditure ratios were increasing above 2.4% on a year-over-year basis from 2013 to 2017. The index in 2015 hit to the peak point as 113.6%, probably because colleges substantially increased tuition in 2015. From points of view in college, the increasing tuitions resulted from the cost of running schools, such as faculty salaries, college relocating and college expansion. Therefore, as time flies, from students' points of view, the educational expenditure is increasing in areas like tuition, extracurricular courses, and textbooks. If the tax deductible standard will be adjusted once in a few years, the new standard will fall behind the increasing residential price and economic development. Moreover, it will not continuously reflect the taxpayer's real tax burden.

Table 1 China's consumer price index in the resident education from 2012 to 2017

China	
consumer price index in the resident education (Last year=100)	
2017	103.00
2016	102.40
2015	113.60
2014	102.40
2013	102.70
2012	101.70

The paper also takes Canada as an example, by considering the impact of inflation; Canada will adjust the personal income tax and benefits according to the consumer price index (CPI) yearly, such as increasing the tax bracket thresholds, adding up amounts of the nonrefundable tax credit and rising contributions in the social welfare. The usage of index adjusted personal income tax method can take account of growth in the whole economy and changes in the inflation to the personal income tax, and can reduce numbers of amendments on the tax act. Therefore, because of changes in the consumer price, Canadian taxation system can directly reflex changes in the tax environment on the income tax payments of taxpayers.

Compared with China, if annually sampling the average children's educational expenditure is used by the government to set the deductible standard in the IIT, the cost of survey will be quite

high because it has to survey residential educational costs annually or once in a while. Therefore, the paper recommends to use the Canadian inflation adjustment method on the special deductions in children's education. [5] (Xia, Yang, & Li, 2019) had a suggestion on the inflation adjusted method. The specific formula is the deductible standard for children's educational expenditure in this year = the deductible standard for children's educational expenditure in the previous year* (1+ inflation rate in the previous year) (p.171). This method is easy to operate, reduces costs of sampling surveys and takes into account of changes in the tax environment.

2.3 Trueness of tax returns.

The tax law does not take into account of improvement of information-based IIT filing system and penalties on income tax fraud. Tax evasion has always been the main focus of tax departments, also related regulations and penalties are gradually being perfected. Since the Chinese IIT declaration system is mainly based on the withholding agents, taxpayers' self-declaration is supplementary. With implementation of the new income tax code and the development of internet, more and more tax filing information needs tax departments to verify its trueness, accuracy and completion; furthermore, tax residents will file their income tax settlements in the future, and any amount in excess should be refunded and any amount in deficiency should be made up. There are three pieces of influence for the true filing. First of all, the withholding agents are under pressure to honestly file personal income tax returns according to law: the withholding agents should accurately file employees' salaries and remuneration according to the true information of employees, and carefully verify the authenticity for the additional special deduction of their workers. Secondly, since the social security system currently is not connected with the tax system, it is difficult for the tax bureau to get taxpayers real information and impose the tax inspection. Thirdly, the tax bureau should remind taxpayers to correct their wrong IIT returns, and the tax collectors should enforce joint punishment for tax crime if the withholding agents and taxpayers do not cooperate with tax inspections or dishonestly declare their salaries and additional special deductions.

Developed countries pay special attention to the tax data and informational collection, and tax officers will send notice of assessments to high risk taxpayers. Taken the United States as an example, [4] (Wu, Li, & Wang, 2018) studied IIT system in the United States. The tax inspection of IIT uses a two-way declaration system which makes employers and taxpayers file their returns separately. If a taxpayer and a related person earn income and claim deductible expense, the Internal Revenue Service (IRS) will make both sides declare related income and deductible expense. The supporting documents will be kept for future tax inspection (p.20). For example, if a taxpayer files a larger than normal amount of tuition or medical tax deductible expenses, it may cause the IRS's attention and get a tax inspection. How does the IRS get taxpayers' information? [4] (Wu, Li, & Wang, 2018) showed several ways for the IRS to collect taxpayers information. Firstly, the United States has brought in legislation to guarantee the cooperation between third parties and the IRS. Secondly, there is a sound internet network in the information connection among different departments in the United States. The tax system connects with banks, social security and employer's income tax returns so that the IRS collects taxpayers' information in a true, accurate and complete way. (p. 20)

Compared with the United States, China should build a personal credit system in Chinese society for honestly filing taxpayers' income tax returns. With establishment of the classified comprehensive IIT collection system and six special additional deductions, (National Development and Reform Commission, State Taxation Administration, 2019) [2] stated that the tax bureau gave much attention to build the taxpayers credit system. Moreover, the tax system that uses big-data to check taxpayers' IIT declaration and special additional deductions has gradually been improved. This paper puts forward following suggestions to build a credit system in China: To start with, the tax bureau should educate taxpayers and withholding agents to honestly file personal income tax returns. The tax departments should use taxpayers' personal ID as the tax identification numbers as a key aspect to enforce personal income tax inspections to the withholding agents as they honestly file employees' income tax returns. Furthermore, the tax bureau could require withholding agents to

make a commitment to their filings in the income tax returns as truly, accurately and completely. Secondly, the paper suggests building the taxpayers' credit record for payment of IIT. The payment history of IIT can be checked by taxpayers from different sources such as government websites, mobile phone apps or tax bureaus. The paper also suggests working on the data sharing networks. The tax bureau can collect and compare the taxpayer's residential information with the individual income tax data from the tax bureau system. It is helpful for the tax bureau to connect information and data among police stations, schools or educational institutions, banks, social insurance departments, civil affairs bureaus and employers' salary returns data. If the declaration data from taxpayers does not match with the data from the tax bureau, the tax collectors should remind taxpayers to modify their filing information or let them to explain why they file their tax returns in this way. Thirdly, the paper suggests establishing a mechanism of dishonest acts. China should advocate and build the rule of law in society. According to the related laws, tax evaders and tax crime should be punished or jailed. For people who are against the tax law, the tax evading behavior should be recorded in their personal credit files.

3. Conclusion

Based on Chinese fundamental realities, the paper used advantages of tax collection and management from a few developed countries for reference. The current focus of attention in China has been gradually reforming the personal income tax to show fairness in tax payments to the general public. The paper has discussed existing problems of China's current taxation system in the special deduction of children's education, and gave several recommendations to improve the IIT law. First of all, the children's education deductible should include expenses for the 0-3 years old children. Secondly, the deductible amount of children's education should be adjusted according to the inflation index. Finally, a personal credit management system for paying IIT should be established. The State Council could make amendments to refine and improve the special deduction for children's education in the IIT. Moreover, the IIT is subject to a macro-control in the distribution of wealth so that taxpayers can pay taxes fairly.

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