



## Challenges and Opportunities of Local Tax System in China

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### Abstract

Local tax is an important ingredient of tax system in China. With the improvement of market-oriented economic system in China, reforming current local tax system, assimilating successful experience of foreign countries and establishing proper local tax system have become an objective demand, which has great significance to the development of China's economy. In this paper, some management policies have been put forward in order to deal with certain problems of local tax system in China, on the basis of current situation of local tax system in China, as well as the social and economic changes in China. Meanwhile, successful experience abroad has been analyzed, which can provide inspirations of reforming and improving the local tax system in China.

**Keywords:** Local tax system; tax category; structural reform; tax collection mode

### 1. Introduction

Local tax system is an important component of the tax collection system in China [1]. Most countries in the world, including China, has already established local tax system based on tax distribution principle [2]. Building perfect local tax system in current market-oriented economy is believed to be an important component of taxation by law, which serves as the starting point of adjusting finance distribution of central and local administrations and fully stimulating the enthusiasm of both sides. However, current local tax system in China lags behind social and economic development. Therefore, a new round of reform in China is needed with urgency.

Reforming local tax system in China and constructing the local tax system suitable for national conditions are needed for perfecting Socialist market-oriented economic system, which is in close relationship with the development of local economy. Reforming local tax system in China and constructing the local tax system can also promote transformation of government functions, taxation by law and successful system of public finance. Additionally, reforming local tax system in China and establishing the local tax system can help realize Socialism with Chinese characteristics and build harmonious society, which is in connection with the economic development of the whole society.

In this paper, reforming and improving the local tax system in China has been discussed on the basis of current situation of local tax system, as well as the social and economic changes

in China. Through analyzing successful experience abroad, directions of reforming and improving the local tax system in China have been pointed out.

### 2. Certain unresolved problems in the local tax system of China

There are a few problems, which needs to be solved in reforming the local tax system.

#### 2.1 The distribution of tax power between central and local administrations

##### 2.1.1. The distribution of tax power is not scientific, with financial power and routine power inconsistent

The conflicts of ill-matched financial power with routine power become increasingly prominent. Local tax revenue cannot become the principal part of local financial source. The tax distribution system gives only minor tax categories to local administration, which cannot become the major source of local financial system. In summary, tax distribution fiscal administration system is not operated very well.

##### 2.1.2. Highly centralized tax power in conflicts with tax distribution power.

The administrative power for tax collection is not disposed in a reasonable manner, which becomes an obvious defect in

current tax distribution system. In particular, the right of local tax management is not conferred well. Local government has no right in legislation of tax ordinance and setting up local tax categories, which can lead to two negative outcomes inevitably: 1. Current local tax administration system adjusts badly to the requirement for establishing market-oriented economy; 2. The management power of local tax is highly concentrated on the central administration, which is not beneficial for the local tax collection and economic development.

## **2.2 The structure of local tax system and the establishment of principal tax category**

For a long time, the central and local tax categories are divided in an unscientific manner, which is believed to be unreasonable. There exists certain specific issues and implications. Firstly, the classification criteria of local tax are not scientific, with certain tax categories belonging to wrong area. Secondly, the local tax system is old-fashioned and there is a vacancy in the set-up of tax category, which violates market mechanism. Thirdly, there is a shortage of principal tax categories, which has a bad impact on local tax revenue.

## **2.3 The reform of local tax system**

The reform of tax system is mainly concentrated on national tax in recent years, whereas the degree of reform in local tax system is not enough. Current local tax system has certain unresolved issues: Firstly, some local tax categories are very old in content, which does not adapt to current state of economic development. Secondly, there exist different internal and external tax systems in current local tax. Domestic enterprise and foreign enterprise have unfair tax burden, which is not beneficial for the integration into global tax system. Thirdly, certain tax categories need to be established and collected, which suits the requirement for current economic development and variance of resident income.

## **3. Lessons learned from the successful experiences abroad**

Nowadays, most countries in the world use tax distribution policies to deal with the financial resources between central and local governments, which can help establish standard and intact local tax system according to the situation of their own countries [3]. This tax system has already played an important role in the social and economic development of each country [4]. Reforming the local tax system in China should make full use of these successful experience abroad in order to deepen the understanding of local tax system. The basic experiences of local tax system abroad can be discussed briefly as

### **Follows:**

Firstly, dividing tax power according to national conditions sets the foundation on operating local tax system. The distribution of tax power in each country coincides with the state system and

regime. The dominance of central tax power is in appropriate connection with conferring the local tax power. Importance should be attached to local tax system in the whole tax system, under the premise of endowing sufficient financial power of central government. Relevant law can be made, which is in flexible combination with the elasticity of distributing tax power.

Secondly, the core of functioning local tax system is to design the tax system in a scientific and reasonable way. Most countries execute compound tax system. Various categories, multilevel and multiple-step are utilized in tax collection, which ensures normal operation of local government. There are various major tax categories in the local tax system of each country. Meanwhile, every country attached great importance to the set-up of auxiliary tax. Additionally, the tax source possess separability. This type of tax sharing structure has guaranteed the increasing flexibility of local tax source [5].

Thirdly, local tax administration has been set up individually in the local government of each country with the aid of perfect tax system, which makes sure that local tax system can operate effectively.

Fourthly, there is relevant transfer payment system in each country, which becomes an important supplement to operating local tax system. Those experiences mentioned above have given us a lot of inspirations. Reforming the local tax system in our country should consider the basic development trends and obey general rule of international local tax system. Scientific and standard local tax system should be established according to social, political and economic conditions of our country so that the local administration can have relatively independent tax management power and steady principal taxes [6].

The local tax should be enlarged gradually when the dominance of national tax is maintained and the ability of central administrative macro-regulation is strengthened. The order of distribution should be further rationalized and the pace of tax reform should be accelerated. All these strategies can help promote the local economy, which fits for the actual conditions of local place [7].

## **4. Advice on reforming and improving the local tax system in China**

Since certain problems in current local tax system in China exist and need to be solved, the policy recommendations about reforming local tax system in China can be listed as follows according to those successful experiences abroad:

1. Reform the financial management system in current tax sharing system, divide the tax power rationally and confer local tax legislative power. First of all, divide the routine power of national and local administrations clearly in order to confirm the property power and tax power in national and local administrations. National affairs should be afforded by the central financial system whereas local finance should be responsible for local affairs. All levels of governments should own corresponding property power and financial resources.

Secondly, the tax categories of central and local administrations should be set up in a scientific and rational way. The central and local administrations should own principal tax and sufficient tax sources, so as to ensure the property power and financial resources of all levels of governments. It is necessary to divide the tax power carefully in order to identify correct property power between central and local administrations. These management policies should be taken properly, which suits local circumstances.

Thirdly, the financial transfer payment should be normalized in China, while adhering to efficiency and fairness. The basic law of tax collection should be made rapidly. The legislation of tax collection and tax category should be conferred to the local government within reasonable limits.

2. The central and local administrations should divide the tax categories in a scientific and rational manner, reform the establishment of local tax category and build stable local tax collection system. The routine power and financial power in tax distribution system should be unified. On the basis of identifying and confirming the financial power of all levels of governments, the tax categories of central and local administrations can be divided. Current local tax categories should be unified, adjusted, canceled or levied after thorough investigation.
3. Local principal tax should be cultivated. Property tax should be progressively identified and confirmed as the local principal tax.
4. The relationship between tax collection and management should be further straightened out, and the level of local tax management should be improved.

## 5. Conclusions

Reforming the local tax system is an objective requirement for further improving the socialist market economy system, transformation of government functions and establishing

the system of public finance, which will definitely have great significance and profound impact. Therefore, it is necessary to reform the current local tax system in a timely manner, according to the new demand of social and economic development of China. The country should proceed from the perfection of the market-oriented economic system and building a harmonious society. Then the relationship between the central and local tax systems should be mediated properly in order to stimulate the enthusiasm of both sides. At the same time, reforming the local tax system is a systematic project, which needs the cooperation of economic, political and social systems. Reforming the local tax system will also be a gradual process. The stability of economy and society should be ensured and certain successful experience abroad should be considered and used. Eventually, certain policies or strategies regarding local tax reform can be made, which fits well for China's actual conditions.

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