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A Tale of Two Taxes: A Comparative Examination of the Individual Income Tax in the United States and the People's Republic of China

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A TALE OF TWO TAXES: A COMPARATIVE EXAMINATION OF THE INDIVIDUAL INCOME TAX IN THE UNITED STATES AND THE PEOPLE'S REPUBLIC OF CHINA

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Man is not like other animals in the ways that are really significant: animals have instincts, we have taxes.

Erving Goffman

I. INTRODUCTION

Individual income taxes have only existed in China since 1980, when they were enacted to tax a very limited segment of the Chinese

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population. Even today, China relies heavily on other sources of revenue to fund government operations.[1] In the United States, on the other hand, the history of the individual income tax stretches back to the U.S. Civil War in 1861. In contrast to the limited role the individual income tax plays in China, it provides nearly half of the revenue of the United States federal government.[2]

The goal of this article is to provide a comparative examination of the individual income tax systems of China and the United States. In comparing the two individual income tax systems, a number of similarities will be observed. For example, in both systems the definition of income to be taxed is quite broad, and both systems incorporate a system of exemptions (though significant differences still exist in how the two systems approach exemptions and deductions). Both systems employ progressive rate structures, although they differ as to the appropriate degree of progressivity. On the other hand, there are very significant differences between the two systems. For example, many of the exemptions that exist in the Chinese tax law are uniquely Chinese, reflecting very different cultural concerns than those that exist in the United States.

Parts II and III of the article provide an overview of the Chinese and United States individual income tax systems, respectively. For each system, the article provides a brief history of the tax from its introduction to the present, the coverage of the tax and how it is calculated, and a discussion of the collection and withholding requirements of the tax. Part IV provides a comparison of the Chinese and United States systems in four key areas: (1) who is subject to the tax; (2) the definition of income for tax purposes and the exemption of certain income from taxation; (3) the rate structure and progressivity of each system; and (4) the fairness of each system as a matter of tax policy.

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[1] In 2012, revenue from the individual income tax totaled 582.02 billion yuan ($92.69 billion U.S.), accounting for 5.8 percent of the total fiscal revenue of the Chinese government. *China's Personal Income Tax Revenue Slows Sharply*, XINHUANET (Feb. 11, 2013), http://news.xinhuanet.com/english/china/2013-02/11/c_132164722.htm.

[2] In fiscal year 2011 (the latest year for which full data is currently available), the United States had total revenue of $2.3 trillion, $1.091 trillion (47.7%) of which was from individual income taxes. *Budget Infographic – Revenues*, CONGRESSIONAL BUDGET OFFICE (Apr. 17, 2012), http://www.cbo.gov/publication/43153.

II. THE CHINESE INDIVIDUAL INCOME TAX LAW

A. *History of the Chinese Individual Income Tax Law*[3]

China's first individual income tax was enacted in 1980.[4] This tax primarily targeted high-income foreign professionals working in China by allowing a deduction of 800 yuan per month, a level sufficient to exempt most Chinese citizens from the tax.[5] The State Council adopted regulations[6] to apply the tax broadly to Chinese citizens and to individual entrepreneurs using a lower deduction of 400 yuan per month.[7] These regulations were rescinded when the individual income tax law ("IITL") was revised in 1994,[8] and the State Council issued new implementing regulations that primarily defined many of the terms contained in the law.[9] In September 2011, the IITL was again revised to its current form.[10] The 2011 amendments included an increased exemption amount (resulting in an estimated 60 million Chi-

[3] The discussion in this article is limited to a brief history of the Individual Income Tax Law. For an excellent discussion of the history of general taxation in China, *see* Xu Yan, *No Taxation Without Representation: China's Taxation History and Its Political-Legal Development*, 39 Hong Kong L. J. 515 (2009).

[4] [Individual Income Tax Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Sept. 10, 1980, effective Sept. 10, 1980).

[5] Hua Xu and Huiyu Cui, *Personal Income Tax Policy in China and the United States: A Comparative Analysis*, Pub. Admin. Rev., Dec. 2009, at S75, S76.

[6] [Adjustment Tax on Individual Income Provisional Regulations] (promulgated by the St. Council, Sept. 25, 1986, effective Jan. 1, 1987) (last visited Mar. 7, 2013) (China) *available at* http://www.novexcn.com/ind_inc_adjust_tax.html.

[7] Xu, *supra* note 5.

[8] [Individual Income Tax Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 31, 1993, effective Jan. 1, 1994), (rev. by the Standing Comm. Nat'l People's Cong., Aug. 30, 1999), (rev. by the Standing Comm. Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006) (LawInfoChina).

[9] [Detailed Rules for the Implementation of the Individual Income Tax Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Jan. 28, 1994, rev. Dec. 19, 2005) (LawInfoChina) [hereinafter *Implementing Regulations*].

[10] [Individual Income Tax Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Sept. 10, 1980) (rev. by the Standing Comm. Nat'l People's Cong., June 30, 2011, effective Sept. 1, 2011) (LawInfoChina) [hereinafter *IITL*]. Except as otherwise indicated, references to the *IITL* are to the September 2011 version.

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nese being exempted from the tax)[11] and a decrease in the number of income tax brackets from nine to seven.[12]

B. Coverage and Calculation of the Chinese Tax

The IITL taxes individuals domiciled in China[13] or residing in China for a year or more[14] on their worldwide income.[15] Other individuals are taxed under the law on their income "gained within China"[16] subject to a deduction from the amount of individual income tax paid outside China.[17] The IITL applies to eleven categories of income, nine of them very specific[18] and two of them very broad.[19] Cer-

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[11] *See* Peter Ford, *China to Cut Income Tax for 60 Million People*, THE CHRISTIAN SCIENCE MONITOR (Aug. 31, 2011), http://www.csmonitor.com/World/Asia-Pacific/2011/0831/China-to-cut-income-tax-for-60-million-people.

[12] *See* Xinhua, *New Regulations for Amended Personal Income Tax Law*, CHINADAILY.COM.CN (Jul. 27, 2011), http://www.chinadaily.com.cn/bizchina/2011-07/27/content_15953325.htm.

[13] *See Implementing Regulations, supra* note 9, art. 2 (An individual is considered domiciled in China if, by reason of their registered permanent residence, families, or economic interests, they have habitual residence in China).

[14] *See id.* art. 3 (An individual resides in China for a year or more if she has resided within the territory of China for 365 days in a tax year. No deduction is made for temporary trips outside China, defined as absence from China for not more than 30 days in a single trip, or not more than a cumulative total of 90 days over a number of trips, within the same tax year).

[15] *See id.* art. 1.

[16] *See id.* art. 1. The term "income derived from sources within China" means income, the source of which is inside China, and "income derived from sources outside China" means income, the source of which is outside China. *See Implementing Regulations*, *supra* note 9, art. 5(1)-(5). Under the regulations, the following types of income are deemed to be income gained within China, whether paid in China or not: income from services provided inside China during employment or performance of a contract; income from the lease of property to a lessee for use inside China; income from the transfer of property in China (including buildings, land-use rights, or any other property); income from the licensing of various proprietary rights in China; and income from interest, dividends and bonuses derived from companies, enterprises and other economic organizations or individuals in China.

[17] *IITL*, *supra* note 10, art. 7.

[18] The specific categories of income are: (1) income from wages and salaries; (2) income from production or business operations by self-employed industrial and commercial households; (3) income from contracted or leased operation of enterprises or institutions; (4) income from remuneration for personal services; (5) income from author's remuneration; (6) income from royalties; (7) income from interest, dividends, and bonuses; (8) income from the lease of property; (9) income from the transfer of property. *IITL*, *supra* note 10, art. 2(1)-(9). These categories are more specifically detailed in the implementing regulations. *See Implementing Regulations*, *supra* note 9, art. 8(1)-(10).

tain types of income are specifically exempt, including: awards granted by various levels of the Chinese government or by foreign or international organizations in the fields of science, education, technology, culture, public health, sports and environmental protection; interest on Chinese government debt; subsidies and allowances provided by Chinese regulations; welfare benefits, pensions for deceased family members, and relief payments; insurance indemnities; military severance pay; settlement pay, severance pay and retirement pay, as well as full-pay retirement pensions for veteran cadres and their living allowances, received by cadres and workers under state regulations; income of diplomatic representatives and consular officers and foreign embassy personnel; income subject to exemption according to international tax treaties; and income exempted by the approval of the department of finance under the State Council.[20] The law also provides an opportunity for reduction of tax upon approval for (1) income of the disabled, the aged without families, and the family members of martyrs; (2) those suffering great losses from natural disasters; or (3) other circumstances approved by the Department of Finance under the State Council.[21]

The rates applicable to a particular taxpayer[22] depend upon the sources of that taxpayer's income. The IITL applies progressive rates to certain categories of income (such as wages and income from production and business operations[23]) and fixed rates to others (including authors' remuneration, personal services, royalties, interest and dividends).[24] The progressive rates applicable to wages and salaries range from 3% to 45%[25] of taxable income, which is calculated as wages and salaries after applying a monthly deduction of 3,500 RMB[26]

[19] The broad categories of income are: (10) incidental income and (11) income from other sources specified as taxable by the department of finance under the State Council. *IITL*, *supra* note 10, art. 2(10)-(11).
[20] *IITL*, *supra* note 10, art. 4(1)-(10).
[21] *Id.* art. 5(1)-(3).
[22] The IITL applies to each individual taxpayer separately. Some commentators have suggested taxing on a family basis rather than an individual basis would be more fair. *See* He Bolin, *Income Tax on Families Would be Fairer*, CHINA DAILY, Apr. 20, 2012, http://www.chinadaily.com.cn/bizchina/2012-04/20/content_15953288.htm.
[23] *IITL*, *supra* note 10, art. 3(1)-(2).
[24] *Id.* art. 3(3)-(5).
[25] *Id*. art. 3(1).
[26] All categories of income under the IITL are computed in terms of Renminbi (RMB), with income in foreign currency converted into RMB according to the foreign exchange rate quoted by the State foreign exchange control authorities. *IITL*, art. 10. The Renminbi is the official currency of the People's Republic of China. *People's Republic of China's First Set of RMB Overview*, SINA FINANCE, http://finance.sina.com.cn/money/collection/youbika/20050901/15471935211, *translated at*

for expenses.[27] For income from production and business operations, the rates range from 5% to 35%,[28] applied after deducting costs, expenses and losses[29] from the gross income during a tax year.[30] The fixed rate for author's remuneration is 20%, with the amount of tax payable reduced by 30%.[31] The rate applicable to personal services,

Google Translate, http://translate.google.com (last visited Feb. 24, 2013). The primary unit of measurement for RMB is the yuan. As of February 22, 2013, the exchange rate is 6.2350. *Exchange Rates: New York Closing Snapshot*, WALL. ST. J., http://online.wsj.com/mdc/public/page/2_3021-forex.html (last visited Feb. 24, 2013).

27 *IITL*, art. 6(1). Wages & Salaries: The rate schedule is specified in seven brackets as follows:

Monthly Taxable Income	Tax Rate
1,500 RMB or less	3%
Between 1,500 and 4,500 RMB	10%
Between 4,500 and 9,000 RMB	20%
Between 9,000 and 35,000 RMB	25%
Between 35,000 and 55,000 RMB	30%
Between 55,000 and 80,000 RMB	35%
In excess of 80,000 RMB	45%

IITL, Schedule 1: Individual Income Tax Rates (Applicable to Income from Wages and Salaries).

28 *IITL*, art. 3(2). Production and Business Operations Income: The rate schedule is specified in 5 brackets as follows:

Annual Taxable Income	Tax Rate
15,000 RMB or less	5%
Between 15,000 and 30,000 RMB	10%
Between 30,000 and 60,000 RMB	20%
Between 60,000 and 100,000 RMB	30%
In excess of 100,000 RMB	35%

IITL, Schedule 2: Individual Tax Rates (Applicable to income gained by self-employed industrial and commercial households from production or business operations, and income gained by enterprises and institutions from contracted or leased operation).

29 "Costs" and "expenses" are defined as all direct expenditures, indirect expenses allocated as costs, and marketing, administrative and financial expenses incurred by taxpayers while engaging in production and business operation. The term "losses" means all non-operating expenditures incurred by taxpayers in the course of production and business operation. *Implementing Regulations*, *supra* note 9, art. 17.

30 *IITL*, *supra* note 10, art. 46. The term "tax year" is defined as a calendar year (January 1 – December 31). Implementing Regulations, *supra* note 9, art. 46.

31 *IITL*, *supra* note 10, art. 3(3).

royalties, interest, dividends, property leases, transfers of property, incidental income, and income from other sources is 20%, although extremely high one-time payment for services[32] can be subject to an additional tax under specific measures prescribed by the State Council.[33] These fixed rates apply to income from personal services, royalties, and property leases after a deduction of 800 RMB for expenses from amounts received in a single payment up to 4,000 RMB or after a deduction of 20% for a single payment of 4,000 RMB or more.[34] In taxing income from transfers of property, a deduction is allowed for the original value of the property and the reasonable expenses from the income gained from the transfer.[35] For interest, dividends, incidental income, and income from other sources, no deductions are allowed.[36]

C. *Tax Collection and Withholding in China*

In order to facilitate collection of the individual income tax, the law uses a system of withholding at the source. The paying entity is treated as a withholding agent[37] and is responsible for filing tax returns and paying over the tax withheld on a monthly basis.[38] Taxpayers who receive income from two or more sources, or in situations where there is no withholding agent, must file tax returns in accordance with State regulations.[39]

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[32] The regulations indicate that this addition applies to a payment received by an individual at one time as remuneration for personal services with an amount of taxable income exceeding 20,000 yuan. The additional tax is 50% of the amount between 20,000 and 50,000 yuan, and 100% of the amount that exceeds 50,000 yuan. *Implementing Regulations*, art. 11.

[33] *IITL*, *supra* note 10, art.3(4)-(5).

[34] *Id.* art. 6(4).

[35] *Id*. art. 6(5).

[36] *Id.* art. 6(6).

[37] *Id.* art. 8. The withholding agent is entitled to be paid a service fee of two percent of the amount of tax withheld. *Id.* art. 11.

[38] *IITL*, *supra* note 10, art. 9. Tax payable on income from wages and salaries for particular industries specified by the State Council and on income from self-employed production or business operations may be computed on an annual basis and paid in advance in monthly installments. Income from contracted or leased operations is also computed on an annual basis and paid within thirty days after the end of the year. Tax on income from contracted or leased operations paid in installments shall be paid in advance within the first fifteen days after each installment, with a final settlement due three months after the end of the year.

[39] *Id.*

III. OVERVIEW OF THE UNITED STATES INDIVIDUAL INCOME TAX LAW

A. *History of the United States Individual Income Tax Law*

The United States enacted its first revenue raising tax, the Revenue Act, in 1861 in an effort to fund the Civil War, creating a Commissioner of Internal Revenue and taxing individual income at a rate of 3% for individuals earning between $600.00 and $10,000.00, and a rate of 5% for individuals earning income greater than $10,000.00.[40] By 1867, the income tax was repealed and the United States derived the majority of its revenue from excise taxes on liquor, beer, wine, and tobacco.[41] The first flat rate federal income tax, enacted by Congress in 1894, was ruled unconstitutional by the United States Supreme Court on the grounds that the tax was a direct tax and not appropriately apportioned on the basis of state populations,[42] as required by the United States Constitution.[43]

The outbreak of World War I in Europe in 1913 encouraged the enactment and ratification of the Sixteenth Amendment,[44] which provided the federal government the power to lay and collect taxes.[45] The first income tax after the enactment of the Sixteenth Amendment imposed a tax on persons with a taxable income up to $20,000.00,[46] though it affected less than 2% of wage earners in the United States

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[40] *Historical Highlights of the IRS*, IRS.ORG, http://www.irs.gov/uac/Historical-Highlights-of-the-IRS (last updated Aug. 1, 2012); The Library of Congress Business Reference Services, *History of the US Income Tax*, LOC.ORG, http://www.loc.gov/rr/business/hottopic/irs_history.html (Feb. 2004).

[41] *Id.*

[42] Pollock v. Farmers' Loan & Trust Co., 15 S.Ct. 673 (Apr. 8, 1895) (holding that a national tax imposed on personal income from real estate investments and rents, as well as personal income derived from personal property investments (stocks, bonds, etc.) was a violation of Art. I, § 9 of the U.S. Constitution because it was a direct tax and not properly apportioned.); *see also History of the US Income*, *supra* note 40.

[43] "Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers. . ." U.S. CONST. art. I, § 2, cl. 3; "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken." U.S. CONST. art. I, § 9, cl. 4.

[44] "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. CONST. amend. XVI.

[45] *History of the US Income Tax*, *supra* note 40.

[46] Jay M. Howard, *When Two Tax Theories Collide: A Look at the History and Future of Progressive and Proportionate Personal Income Taxation*, 32 WASHBURN L.J. 43, 47 (1992).

between 1913-1915.[47] Later codified in 1918, the Revenue Act of 1918 raised considerable revenue to fund World War I and "imposed a progressive income-tax rate structure of up to 77%."[48]

From 1913-1939, the income tax was imposed as part of an annual revenue act that suspended and replaced the prior year's act.[49] Each year's act was essentially the prior year's act and whatever amendments Congress deemed necessary. This process of reenactment made referencing the internal revenue laws difficult. As a result Congress enacted the Internal Revenue Code of 1939 ("IRC") in 1939, the first codified and ongoing version of the U.S. internal revenue law. Major recodifications occurred in 1954 and 1986. The current code is the result of the 1986 recodification and amendments from 1986 to the present.

B. Coverage and Calculation of the United States Tax

Under the IRC, all U.S. citizens and resident aliens[50] are subject to tax on their worldwide income.[51] Nonresident aliens[52] are subject to tax only on income that is U.S. sourced.[53]

An individual's tax liability is computed by multiplying his taxable income by the applicable tax rate and subtracting allowable credits. The computation of taxable income begins with a taxpayer's gross income. The IIRC broadly defines gross income as "all income from whatever source."[54] Gross income includes: wages, salaries, bonuses, commissions, alimony, awards, back pay, business income,[55] compensation for personal services, director's fees, dividends, employee awards, employee bonuses, fees, gains from the sale of property or se-

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[47] *Id.* at 48.

[48] *Historical Highlights of the IRS*, *supra* note 40.

[49] J.S. SEIDMAN, SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME TAX 1938-1861, at 1-294, 422-1007 (Prentice-Hall, Inc. 1953) (1938).

[50] A resident alien is an individual who "is a lawful permanent resident of the United States at any time during [the] calendar year;" or is an individual satisfying the substantial presence test with respect to the calendar year; or an individual electing such status. I.R.C. §§ 7701(b)(1)(A)(i) – (iii) (2010).

[51] I.R.C. § 61 (2010); Treas. Reg. § 1.1-1(b) (2008).

[52] "An individual is a nonresident alien if such individual is neither a citizen of the United States nor a resident of the United States. . ." I.R.C. § 7701(b)(1)(B).

[53] I.R.C. § 871 (2010), *amended by* Pub. L. No. 112-240, 126 Stat. 2313 (2013).

[54] I.R.C. § 61(a) (2010).

[55] Business income is reported as Net Profit from Business or Net Loss from Business. Deductible business expenses include amounts that are ordinary and necessary to carry on the business, to include: advertisements, office expenses, legal/professional services, repairs/maintenance, supplies, taxes/licenses, and utilities. I.R.C. § 162(a) (2010).

curities,[56] interest, pensions, prizes, rental income,[57] severance pay, self-employment income, social security benefits, supplemental unemployment benefits, tips and gratuities, and unemployment compensation less standard deductions and personal exemptions.[58] Some forms of income are considered non-taxable income, including: child support,[59] damages received on account of physical injuries or physical sickness,[60] death payments,[61] dividends on life insurance,[62] gifts,[63] welfare payments and food stamps,[64] and worker's compensation.[65]

From gross income, the taxpayer subtracts certain allowable deductions[66] to determine the taxpayer's adjusted gross income.[67] The deductions commonly used in the computation include moving expenses, alimony paid, etc. The taxpayer then deducts a personal exemption for himself, his spouse and each dependent,[68] and the higher

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56 Exclusions include up to $250,000.00 of the gain on the sale of a personal residence for a taxpayer with single status and up to a $500,000.00 exclusion for a taxpayer with Married filing Jointly status, though such exclusions may be reduced if taxpayer lived in the primary residence for less than 2 years. *See* I.R.C. § 121.

57 Deductions for rental income include: mortgage interest, property taxes, advertisements, cleaning/maintenance, insurance premiums, mortgage premiums, commissions for collecting rental income, property management fees, repairs (painting, appliances, structural repairs, etc.), and utilities paid for tenants. I.R.C. §§ 62(a)(4), 212.

58 *See id.*

59 I.R.C. § 71(c) (2010).

60 I.R.C. § 104(a)(2) (2010). The exclusion from income for damages from physical injury or sickness does not apply to punitive damages except in very limited situations involving civil wrongful death cases in which the relevant state law provides that only punitive damages may be awarded. *See* I.R.C. 104(c).

61 I.R.C. § 101(a) (2010).

62 I.R.C. § 72 (2010).

63 I.R.C. § 102 (2010).

64 Rev. Rule 73-87, 1973-1 C.B. 39.

65 I.R.C. § 104(a)(1).

66 These deductions are commonly called adjustments to gross income or "above-the-line" deductions.

67 I.R.C. § 62 (2010). Adjusted gross income is an important figure in the calculation, since it is used in calculating the taxpayer's allowable deductions in such areas as medical expenses, charitable contributions and miscellaneous business deductions. *See*, *e.g.*, I.R.C. § 67 (2010) (providing that miscellaneous itemized deductions are allowed for a taxable year only to the extent the aggregate of such deductions exceeds 2 percent of adjusted gross income); I.R.C. § 170(b) (limiting deductions for charitable contributions to public charities to 50% of the taxpayer's adjusted gross income, with minor modifications).

68 I.R.C. § 151 (2010). For 2013, the personal exemption is $3,900. Rev. Pro. 2013-15, 2013-5 I.R.B. 444, § 2.11(1), *available at* http://www.irs.gov/pub/irs-drop/rp-13-15.pdf.

of a standard deduction[69] or itemized deductions[70] to arrive at taxable income.[71]

In computing personal income tax liability, the applicable marginal tax rates range from 10%-39.6%[72] and are determined based on the taxpayer's filing status.[73] Married individuals[74] and surviving spouses[75] may file a joint return[76] or a separate return.[77] Additional filing statuses include those for individuals who qualify as a "head of household"[78] and for unmarried individuals (other than surviving spouses and heads of households).[79] Once the taxpayer's taxable income and filing status are determined, the taxpayer then uses tables issued by the IRS to compute his or her income tax liability.[80]

However, to complicate matters further, some types of income receive preferential treatment in the form of different tax rates. These

[69] I.R.C. § 63(c)(2) (2010). The standard deduction varies depending on the taxpayer's filing status and is indexed for inflation. For 2013, the standard deduction amount is $6,100.00 for Unmarried Individuals and Married Individuals Filing Separately; $8,950.00 for Heads of Household; and $12,200.00 for Married Individuals Filing Jointly and Surviving Spouses. Rev. Proc. 2013-15 at § 2.07.

[70] Itemized deductions include medical/dental expenses; taxes paid; home mortgage interest paid; mortgage insurance premiums paid; gifts to charity; job expenses; and certain miscellaneous deductions. I.R.C. § 63(d) (2010); *see also* I.R.C. §§ 67, 68 (2010).

[71] I.R.C. § 63(a) (2010).

[72] A high-income taxpayer's effective marginal tax rate may exceed 39.6% due to special rules requiring a phaseout of itemized deductions and personal exemptions at certain levels of adjusted gross income. *See* I.R.C. § 68(b)(2) (2010); I.R.C. § 151(d) (2010). Although these phaseout rules expired at the end of 2009, they were reinstated by the American Taxpayer Relief Act, Pub. L. No. 112 – 240, 126 Stat. 2317, § 101 (2012).

[73] I.R.C. § 1 (2010).

[74] The determination of marital status is generally made as of the close of the taxpayer's taxable year. However, in the year of the death of an individual's spouse, the determination is made at the time of the spouse's death. I.R.C. § 7703(a)(1) (2010).

[75] The term "surviving spouse" means a taxpayer whose spouse died during either of the two taxable years immediately preceding the current taxable year, who maintains a home which is the principal residence of a dependent who is a child or stepchild of the taxpayer, and who has not remarried at any time before the close of the taxable year. I.R.C. § 2(a) (2010).

[76] I.R.C. § 1(a) (2010).

[77] I.R.C. § 1(d) (2010).

[78] I.R.C.§ 1(b) (2010). The term "head of household" refers to an unmarried individual (other than a surviving spouse) who maintains a home for a dependent child (meeting certain conditions) or a dependent parent of the taxpayer.

[79] I.R.C. § 1(c) (2010).

[80] I.R.C. § 1; *see also* Rev. Proc. 2013-15 at § 2.01. The rate schedules are located in Appendix 1.

preferential rates apply primarily to corporate dividends and long-term capital gains, which in 2013 are taxed at 20% for taxpayers in the 39.6% ordinary income bracket, 15% for taxpayers in the 25-35% ordinary income brackets, and 0% for taxpayers in the 10-15% ordinary income bracket.[81]

Finally, a taxpayer may be eligible for various tax credits.[82] These include childcare/dependent care expense credits, child tax credits,[83] education credits including the American Opportunity Credit[84] and Lifetime Learning Credit,[85] Earned Income Tax Credit,[86] Credit for the Elderly or the Disabled,[87] Residential Energy Credits,[88] and the Foreign Tax Credit.[89]

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[81] I.R.C. § 1(h) (2010). Beginning in 2013, an additional 3.8% tax applies to a taxpayer's "net investment income" for taxpayers with modified adjusted gross income of $200,000, $250,000 in the case of a married couple filing a joint return, or $125,000 in the case of a married couple filing separate returns. I.R.C. § 1441 (2010).

[82] A tax credit is a credit against income tax itself, whereby the amount is subtracted from tax liability, as opposed to a gross income deduction. BLACK'S LAW DICTIONARY 1501 (8th ed. 2004); *see* I.R.S. Topic 600, 601-02, 607-08, 610-12 (August 11, 2011), http://www.irs.gov/taxtopics/tc600.html.

[83] I.R.C. § 24 (2010).

[84] The American Opportunity Credit permits a credit up to $2,500 per eligible student for four (4) tax years, of which 40% is refundable. I.R.C. § 25A(i) (West 2012). This credit applies to students pursuing an undergraduate degree or other recognized educational credential, enrolled in a part-time or full-time program. The credit may be reduced if the modified adjusted gross income ("AGI") is between $80,000-90,000 for single status taxpayers (or $160,000-180,000 if married filing jointly). AGI is defined as gross income minus deductions. I.R.S. Pub. 970 (2011), http://www.irs.gov/pub/irs-pdf/p970.pdf.

[85] The Lifetime Learning Credit allows a credit of up to $2,000 per return and is available for all years of post- secondary education and for courses to acquire or improve job skills. I.R.C. § 25A(c). A taxpayer claiming the Lifetime Learning Credit need not pursue a degree. The credit may be reduced if the modified AGI is between $50,000-60,000 for single status taxpayers (or $100,000-120,000 if married filing jointly). I.R.S. Pub. 970.

[86] The Earned Income Tax Credit is a tax credit for low to moderate income working individuals and families which a taxpayer may qualify for based upon certain requirements. I.R.C. § 32, *amended by* Pub. L. 112-240, 126 Stat. 2313 (West Jan. 2, 2013). I.R.S. Topic 601. I.R.S. Pub. 596 (2011).

[87] I.R.C. § 22 (2010) (for qualified individuals whose income does not exceed certain limits).

[88] I.R.C. § 25D (2010).

[89] The Foreign Tax Credit helps U.S. Citizens and Resident Aliens avoid double taxation on worldwide income. I.R.C. § 901 (2010). To qualify, the taxpayer must have income from a foreign country upon which the taxpayer paid taxes on that income. Earned income in the following countries does not qualify for the foreign

C. Tax Collection and Withholding in the United States

An employer is required to withhold income tax on each of an employee's wage payments.[90] Wages subject to withholding include all payments for services performed by an employee for an employer, including salaries, fees, bonuses and commissions, as well as non-excluded fringe benefits, pensions, and retirement pay.[91] An employer who fails to withhold or pay over income taxes from an employee's wages is liable for the payment of tax that should have been withheld.[92] In addition to employer withholding, the Code provides for withholding on gambling winnings (other than bingo, keno, or slot machine winnings) of more than $5,000,[93] and for withholding on taxable payments from employer-sponsored retirement plans.[94] Certain taxpayers (primarily self-employed individuals) may effectively be required to make estimated tax payments during the course of the tax year.[95] While these estimated tax payments are not technically required, the law imposes a penalty on individuals for failure to pay enough taxes through either withholding or estimated payments.[96]

IV. COMPARISON OF CHINA AND U.S. INDIVIDUAL INCOME TAX LAWS

This section of the article provides a comparison of the Chinese and United States individual income tax systems in four key areas: (1) who is subject to the tax; (2) the definition of income for tax purposes and the exemption of certain income from taxation; (3) the rate structure and progressivity of each system; and (4) the fairness of each system as a matter of tax policy.

A. Who is Subject to the Tax?

Both China and the U.S. IITL tax worldwide income for those residing within the country, with China imposing a tax on individuals "domiciled in China or residing in China for a year or more," and the U.S. taxing U.S. citizens and resident aliens. The determination of residence for income tax purposes is similar, in that it involves a calcu-

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tax credit: Cuba, Iran, North Korea, Sudan, and Syria. I.R.S. Topic 856 (Aug. 11, 2011), http://www.irs.gov/taxtopics/tc856.html.

90 I.R.C. § 3402(a) (2010).

91 I.R.C. §§ 3401(a) (2010).

92 I.R.C. § 3403 (2010).

93 I.R.C. § 3402(q) (2010).

94 I.R.C. § 3405 (2010). The employee may, however, elect not to have tax withheld. I.R.C. §§ 3405(a)(2), (b)(2).

95 Estimated tax payments are filed on Form 1040-ES and are generally paid in four installments during the year. I.R.C. § 6654(c)(2) (2010).

96 I.R.C. § 6654 (2010).

lation of time spent within the country. However, the precise method of making the calculation and the specific amount of time required to become a resident are different.[97]

The United States also taxes the worldwide income of its citizens. In contrast, China does not tax based on citizenship. Thus, a significant difference in the two systems involves the tax treatment of citizens living abroad. A Chinese citizen who is permanently living overseas would not be domiciled in China, nor would she be a resident of China, so she would not be subject to tax in China. In contrast, a U.S. citizen who lives abroad is subject to tax on worldwide income, subject to exclusion[98] for a limited amount of foreign income[99] and housing allowance,[100] and a credit for any foreign taxes paid on the same income.[101]

B. The Definition of Income and the Exemption of Certain Income from Taxation

In terms of the income subject to taxes, both the China and U.S. taxes are quite broad. While the China IITL specifies categories of income subject to the tax, including two broad categories of "incidental income" and "income from other sources specified as taxable by the department of finance,"[102] the U.S. statute defines "gross income" as "all income from whatever source" and then proceeds to list broad-ranging categories.[103] Both countries exempt certain income, al-

[97] Residence requires residing within China for 365 days in a tax year, excluding temporary trips outside the country. *See* Implementing Regulations, *supra* note 9, art. 3. By contrast, residence in the U.S. is determined based on either legal status as a permanent resident (i.e., a "green card") or residence for at least 31 days in the current tax year, and 183 days for the current and two preceding tax years, calculated on a weighted basis. *See* I.R.C. §§ 7701(b)(1)(A)(i) – (iii) (2010).

[98] The foreign earned income exclusion allows an eligible taxpayer to elect to exclude from income for U.S. tax purposes earned income from foreign sources as well as a housing allowance. I.R.C.§ 911(a) (2010). In order to be eligible the taxpayer must have a tax home in a foreign country and must meet either the bona fide residence test or the physical presence test. I.R.C. § 911(d)(1) (2010). The bona fide residence test requires that the taxpayer be a bona fide resident of a foreign country for an uninterrupted period that includes a full tax year. I.R.C. §§ 911(d)(1)(A), (d)(5) (2010). The physical presence test requires that the taxpayer be present in one or more foreign countries for 330 days out of any consecutive 12-month period. I.R.C. § 911(d)(1)(B).

[99] The maximum amount of foreign income that can be excluded for 2012 and 2013 is $95,100 and $97,600, respectively. Rev. Proc. 2011-52, 2011-45 I.R.B. 701; Rev. Proc. 2012-41, 2012-45 I.R.B. 539.

[100] I.R.C. § 911(a)(2) (2010).

[101] I.R.C. § 901(a) (2010).

[102] *See IITL*, *supra* note 10, art. 2.

[103] *See*, *e.g.*, I.R.C. §§ 61, 62, 121, 162 (2010).

though the precise categories vary widely. Both countries exempt amounts that are provided to assist the poor (welfare benefits, pensions for deceased family members, and relief payments in China; welfare payments and food stamps in the U.S.), certain awards for scientific or educational achievement,[104] and certain insurance payments. China also excludes interest on government debt, severance and retirement pay, and veteran's pensions,[105] while the U.S., perhaps reflecting the more litigious nature of U.S. society, excludes damages and worker's compensation benefits.[106]

The China IITL also provides the opportunity to reduce tax for the needy (the disabled, the aged without families, and the family members of martyrs, as well as those suffering great losses from natural disasters) and under "other circumstances" approved by the Department of Finance.[107] Article 5 of China's IITL is not specific about when these opportunities will apply or how they will be determined, leaving the details seemingly within the hands of the Department of Finance.[108]

In contrast, the U.S. statute seems to build some of these types of exemptions into its system through available deductions. For example, each individual, his spouse and each dependent receives a personal exemption[109] and, at a minimum, a standard deduction amount.[110] For a married couple with two children, the personal exemptions would total $15,600 and the standard deduction would be $12,200 in 2013.[111] Thus, the first $27,800 of income for our hypothetical family is effectively exempted under the U.S. system.[112] Other deductions for expenses such as alimony paid, moving expenses, medical/dental expenses, taxes paid, and charitable contributions[113] can also serve to effectively reduce the amount of income subject to tax.

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104 *See IITL*, *supra* note 10, art. 4(1) – (10); I.R.C. § 74(a) (2010).

105 *See IITL*, *supra* note 10, art. 4(7), I.R.C § 72(a)(2) (2010).

106 *See* I.R.C. § 104(a)(1)-(2) (2010).

107 *See IITL*, *supra* note 10, art. *5*.

108 *See id.*

109 *See supra*, note 69.

110 *See* I.R.C. § 63(c) (2010).

111 I.R.S., *Annual Inflation Adjustments for 2013*, IR-2013-4 (Jan. 11, 2013), *available at* http://www.irs.gov/uac/Newsroom/Annual-Inflation-Adjustments-for-2013.

112 In addition, the U.S. system incentivizes the poor to work through the use of an Earned Income Credit. I.R.C. § 32 (2010). The Earned Income Credit is a refundable credit, meaning it can generate a tax refund to the working poor even if the taxpayers' taxable income is below the threshold amount required to generate a tax liability.

113 *Cf.* I.R.C. § 63(d) (2010).

C. Rate Structure and Progressivity

Both the Chinese tax and the U.S. tax are progressive. An exact comparison, however, is difficult because of the way the governments compute the taxes. Under both the U.S. and China taxes, different rates apply to different categories of income, and the rates and categories for each country differ from one another. Thus, the rates applicable to an individual taxpayer in either country will vary depending on the source of her income, and calculating a single marginal rate of tax is not possible. The differences in the methods of tax calculation make a direct comparison quite challenging.

What is possible, however, is to compare situations involving hypothetical taxpayers at various income levels within the Chinese and U.S. societies. For example, it is possible to compare the average salaries of workers in the U.S. and China who have similar careers. For example, a recent survey[114] compared the average salary by careers for both the U.S. and China.[115] Table 1 below provides a selected comparison of the responses for those careers that appeared in both surveys.

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114 It should be noted that I am making no claim that this survey is statistically sound. It is based on self-selected participants who chose to report their salaries, with no verification of their entries. In addition, the number of entries in the survey is small. I am using these numbers only to demonstrate how the tax might hypothetically apply to individuals with similar careers in the U.S. and China.

115 *See Average Salary in United States*, AVERAGESALARYSURVEY.COM, www.averagesalarysurvey.com/article/average-salary-in-unitedstates/15200316.aspx (last updated Aug. 23, 2013); *Average Salary in China*, AVERAGESALARYSURVEY.COM, http://www.averagesalarysurvey.com/article/average-salary-in-china/15201531.aspx (last updated Aug. 23, 2013).

TABLE 1

	Average Gross Annual Salary United States (in U.S. Dollars)	Average Gross Annual Salary China (in RMB)	Average Gross Annual Salary China (in 2013 U.S. Dollars[116])
Director	147,734	737,000	118,204
General Manager	117,969	782,391	125,484
Software Engineer	96,773	160,925	25,810
Manager	90,738	373,076	59,836
IT Manager	88,737	351,105	56,312
IT Project Manager	86,227	287,250	46,071
Operations Manager	81,237	387,085	62,083
Marketing Manager	80,094	241,284	38,698
Human Resources Manger	75,738	389,871	62,529
Engineer	71,694	157,997	25,340
Accountant	59,571	110,375	17,702

The careers in Table 1 reflect white collar jobs only. An older (but more reliable) salary comparison[117] is available for select jobs and includes blue-collar jobs as well. Table 2 below includes a comparison of some of the jobs from this survey.

[116] The conversion to U.S. dollars is for informational comparison only and is based on an exchange rate of 6.2350, the reported exchange rate as of February 22, 2013. Some of the more surprising results of this comparison are based on the self-selected nature of the participants in the salary survey. In several categories, such as "General Manager", the salary level in China seems extremely high compared to the salary level in the U.S. indicating that the salary information in these categories is not accurate.

[117] *See*, *e.g.*, *International Average Salary Income Database*, *available at* http://www.worldsalaries.org (last visited Mar. 8, 2013) (based on 2005 data).

TABLE 2

	Gross Monthly Income United States (in 2005 U.S. Dollars)	Gross Monthly Income China (in RMB)	Average Gross Monthly Income China (in 2005 U.S. Dollars[118])
Firefighter	3,454	1,166	183
Miner	3,270	1,291	202
Car Mechanic	3,118	1,082	170
Carpenter	3,037	1,133	178
Bus Driver	1,898	1,083	170
Hotel Receptionist	1,749	1,001	157
Baker	1,739	676	106

The data in Tables 1 and 2 show what we would intuitively expect: average salaries in nearly every category[119] are higher in the U.S. than in China. Using these salaries, we can compare the income tax burden of each system on hypothetical taxpayers[120] employed in these various fields in the U.S. and China.[121]

Based on the data in Table 3, the individual income tax[122] in China appears more progressive overall than the U.S. tax. In the U.S., workers in more blue-collar-type jobs (Firefighter through Baker on Table 3) pay a higher effective tax rate than their counterparts in China, whose income is effectively exempt from individual income tax.[123] The effective tax rates for workers in white-collar-type jobs

[118] The conversion to U.S. dollars is for informational comparison only and is based on an exchange rate of 8.0956, the reported exchange rate as of July 31, 2005.

[119] The only category where the salary in China was higher than in the U.S. was the "General Manager" category in Table 1. This anomaly is likely due to the broad term for the category and the self-selection process in the collection of the survey date. *See supra*, note 116.

[120] For comparison purposes, this calculation assumes the taxpayers are unmarried and have no other legal dependents, and, in the U.S., that they are electing the standard deduction rather than itemized deductions.

[121] This comparison is based solely on the impact of the individual income tax system of each country. Other taxes (including payroll taxes, sales taxes and real and personal property taxes in the U.S., and VAT taxes in China) would apply to these workers in varying degrees depending on their personal statistics, locality, and spending habits, among other factors.

[122] It should be noted that this comparison takes into account only the individual income taxes; it does not include other taxes, such as payroll taxes in the U.S., the VAT tax in China, or state/local income or sales taxes in either country. A more detailed comparison involving the total tax burden on citizens of each country would be interesting, but it is beyond the scope of this article.

[123] This difference in the burden of the income tax may be attributable to the socialist nature of the Chinese society.

34080-rgl_12-4 Sheet No. 13 Side B 11/14/2013 11:08:06

TABLE 3

	Gross Monthly Salary	Gross Annual Salary	Annual Tax Payable	Effective Tax Rate	Gross Monthly Salary	Monthly Tax Payable	Annual Tax Payable	Effective Tax Rate
	US	US	US	US	China	China	China	China
	(in U.S. Dollars)	(in U.S. Dollars)	(in U.S. Dollars)		(in RMB)	(in RMB)	(in RMB)	
Director	12,311	147,734	31,859	21.6%	61,417	14,766	177,190	24.0%
General Manager	9,831	117,969	23,525	19.9%	65,199	16,090	193,077	24.7%
Software Engineer	8,064	96,773	17,622	18.2%	13,410	1,473	17,671	11.0%
Manager	7,562	90,738	16,113	17.8%	31,090	5,892	70,709	19.0%
IT Manager	7,395	88,737	15,613	17.6%	29,259	5,435	65,216	18.6%
IT Project Manager	7,186	86,227	14,986	17.4%	23,938	4,104	49,253	17.1%
Operations Manager	6,770	81,237	13,738	16.9%	32,257	6,184	74,211	19.2%
Marketing Manager	6,675	80,094	13,452	16.8%	20,107	3,147	37,761	15.7%
Human Resource Manger	6,312	75,738	12,363	16.3%	32,489	6,242	74,908	19.2%
Engineer	5,975	71,694	11,352	15.8%	13,166	1,412	16,939	10.7%
Accountant	4,964	59,571	8,322	14.0%	9,198	585	7,015	6.4%
Firefighter	3,454	41,448	4,271	10.3%	1,166	0	0	0.0%
Miner	3,270	39,240	3,940	10.0%	1,291	0	0	0.0%
Car Mechanic	3,118	37,416	3,666	9.8%	1,082	0	0	0.0%
Carpenter	3,037	36,444	3,520	9.7%	1,133	0	0	0.0%
Bus Driver	1,898	22,776	1,470	6.5%	1,083	0	0	0.0%
Hotel Receptionist	1,749	20,988	1,202	5.7%	1,001	0	0	0.0%
Baker	1,739	20,868	1,184	5.7%	676	0	0	0.0%

(Director through Accountant) in the U.S. and China varied considerably, depending on the job in question. Based on this data, accountants, engineers, human resource managers, marketing managers and operations managers are more heavily taxed in the U.S., while other managers, software engineers, and directors are taxed more heavily in China.

D. *Fairness of Each System as a Matter of Tax Policy*

The two tax systems can also be compared from a tax policy standpoint. The standard measures[124] of whether a tax is fair and eq-

[124] It is worth noting that there has been an ongoing debate for a number of years over whether horizontal equity has any significance separate and apart from vertical equity. This debate is far beyond the scope of this article. For an excellent

uitable proceed along two dimensions: horizontal equity and vertical equity.[125] Horizontal equity compares the effect of a tax on taxpayers at the same level of economic well-being.[126] Under this principle, those taxpayers with equal economic well-being should face similar tax burdens.[127] Thus, when considering fairness under a horizontal equity concept, two taxpayers with similar income levels and similar family sizes should, all other things being equal,[128] face similar tax burdens. Vertical equity, on the other hand, compares the tax burden of taxpayers of different levels of economic well-being.[129] Under a vertical equity concept, fairness requires that taxpayers with different levels of economic well-being should bear different tax burdens.[130] The argument for a progressive tax system is based on the concept of vertical equity,[131] along with the ability to pay principle, under which a taxpayer's tax burden should be related to the taxpayer's level of economic well-being.[132] Thus, in comparing the tax burden of a taxpayer earning $85,000 per year with that of a taxpayer earning $25,000 per year, vertical equity would suggest that their tax burdens should be different, while the ability to pay principle would suggest that the tax burden of the former should be larger than the tax burden of the latter.

As one might expect, both the U.S. and China systems could be praised as being fair or criticized as being unfair and inequitable, depending on the point of view of the person leveling the praise or criticism for each system. Consider first the U.S. system from the

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summary of the debate and a current analysis of the issues involved, *see*, *e.g.*, James Repetti & Diane Ring, *Horizontal Equity Revisited*, 13 FLA. TAX. REV. 135 (2012).

[125] *See* Walter Hettich & Stanley Winer, *Blueprints and Pathways: The Shifting Foundations of Tax Reform*, 38 NAT'L TAX J. 423, 424 (1985).

[126] JOEL SLEMROD & JON BAKIJA, TAXING OURSELVES: A CITIZEN'S GUIDE TO THE DEBATE OVER TAXES 60 (4th ed. 2008) (hereinafter TAXING OURSELVES).

[127] *Id.*

[128] The question of when "other things are equal" can sometimes be difficult to determine. For example, in considering whether U.S. expatriates should be taxed on their worldwide income in the same manner as domestic taxpayers, it may be worth considering that short-term expatriates, long-term expatriates and accidental expatriates all have varying degrees of ties to the United States and, arguably, should not be considered "equal". *See* Bernard Schneider, *The End of Taxation Without End: A New Tax Regime for U.S. Expatriates*, 32 VA. TAX REV. 1, 44-45 (2012).

[129] TAXING OURSELVES, *supra* note 126, at 59-60.

[130] *Id.* at 59.

[131] As one commentator suggests, "'the desirability of progressive tax structures' is the core question of vertical equity." Jim Chen, *Progressive Taxation: An Aesthetic and Moral Defense*, 50 U. LOUISVILLE L. REV. 659, 676 (2012).

[132] TAXING OURSELVES, *supra* note 126, at 64.

perspective of horizontal equity. The concern with the U.S. system is that two individuals with exactly the same economic income level could (and probably do) have very different tax burdens. For example, assume that two hypothetical individual taxpayers, A and B, both U.S. citizens, who each have $90,000 in gross income. In considering fairness from a horizontal equity perspective, we would expect the two taxpayers with similar incomes to have similar tax burdens. The reality however is different. Taxpayer A's income represents salary earned as an employee. Taxpayer B's income is earned equally from interest, dividends, and capital gains. Taxpayer A's income is taxed at ordinary income rates, as is Taxpayer B's interest income (assuming it is not from tax-exempt sources such as municipal bonds[133]). Taxpayer B's income from dividends and long-term capital gains are taxed at preferential rates. Using 2013 rates, Taxpayer A's tax liability[134] would be $15,929,[135] representing an effective tax rate of 17.7%. Taxpayer B's tax liability would be only $11,554,[136] representing an effective tax rate of 12.8%. As this simple example demonstrates, while the two taxpayers have the same gross income, their relative tax burdens are significantly different.

This example raises another related problem. The fact that Taxpayer B's income is from investment sources might suggest that Taxpayer B is better off economically—i.e., more wealthy—even though the amount of their gross income is the same. Thus, one could argue that the two taxpayers do not have the same level of economic well-being and that, therefore, their tax burdens should not be the same. Under this analysis, the problem is not one of horizontal equity but of vertical equity. While fairness from a vertical equity perspective might suggest that the underlying economic well-being of these two taxpayers justifies a different sharing of tax burdens, the actual result is backwards from what we would expect. The more economically advantaged taxpayer, the taxpayer with the greater ability to pay, is subject to a significantly lower tax burden. Arguably, this result suggests equity concerns in the preferential treatment the U.S. system gives to certain categories of income—in this case, dividend and capital gain income.[137]

133 I.R.S. Pub. 525 (2012), http://www.irs.gov/publications/p525/index.html.

134 As before, these calculations assume both taxpayers are unmarried and filing under a single status, with no other dependents, and electing the standard deduction rather than itemized deductions.

135 I.R.C. § 1(c) (2010).

136 I.R.C. § 1(h) (2010).

137 The U.S. system favors other types of income as well. For example, interest from municipal bonds is tax exempt. I.R.C. § 103(a) (2010). One of the key political issues in the 2012 U.S. Presidential election involved the low effective tax rate of candidate Mitt Romney, whose effective tax rate was only 14.1% in 2011, de-

By comparison, the Chinese system is subject to similar criticisms concerning preferential categories of taxed income. The Chinese system applies a progressive system of taxation to wages and net income from business operations, while a flat rate of 20% applies to certain preferential categories of income, including royalties, interest, dividends, and gains from the transfer of property. Thus, if our hypothetical Taxpayers A and B were Chinese residents rather than U.S. citizens, each earning 561,150 RMB (the equivalent of $90,000),[138] Taxpayer A's income tax liability would be 10,224[139] RMB per month, representing an effective tax rate of 24.1%. Taxpayer B's tax liability would be 9,127 RMB per month, an effective tax rate of 19.5%, reflecting the preferential rates applied to investment income, similar to the U.S. example above.[140]

The same analysis applies here as in the U.S. hypothetical. Taxpayer A is subject to a greater effective tax rate than Taxpayer B, who is likely more economically advantaged. The same ability-to-pay analysis would suggest that Taxpayer B's economic wealth would make it fairer for Taxpayer B to be subject to a higher tax burden than Taxpayer A; and, like the U.S. system, the difference is due to the preferential tax treatment given under the Chinese system to investment income as opposed to salary.

Of course, one cannot consider the preferential tax rates given to investment income in a vacuum. There has been much debate in the U.S. about the benefits of such preferences, both from an economics and a tax policy standpoint.[141] I make no claim in this article to a

spite a taxable income of $13.7 million for that year. John D. McKinnon and Sara Murray, *Romney Offers New Tax Details*, WALL ST. J., September 21, 2012. Mr. Romney's comparatively low tax burden was the result of the categories of income he received (primarily investment income and capital gains). Much of the debate centered around Mr. Romney's receipt of so-called "carried interests" he received as a fund manager with Bain Capital. These carried interests are taxed at preferential capital gain rates rather than ordinary income rates, despite their fundamental nature as compensation. For a detailed discussion of the issues surrounding the tax treatment of carried interests, *see*, *e.g.*, Heather M. Field, *The Return-Reducing Ripple Effects of the "Carried Interest" Tax Proposals*, 13 FLA. TAX REV. 1 (2012).

[138] *See supra*, note 6.

[139] An annual income of 561,150 RMB would be a monthly income of 46,762.50. The monthly exclusion of 3,500 would result in a monthly taxable income of 43,262.50. Tax is then calculated under the rates specified in IITL art. 6(1), 3(2).

[140] *See supra*, note 81 and accompanying text.

[141] *See e.g.,* Annie Lowery, *Politics Complicates the Math in Ending Tax Breaks for the Rich*, N.Y. TIMES (Nov. 20, 2012), http://www.nytimes.com/2012/11/21/business/no-pain-no-gain-in-meeting-in-the-middle-on-taxes.html; John D. McKinnon, *Some Taxes Are Sure to Go Up*, WALL ST. J. (Nov. 4, 2012), http://online.wsj.com/article/SB10001424052970203707604578090981852692500.html.

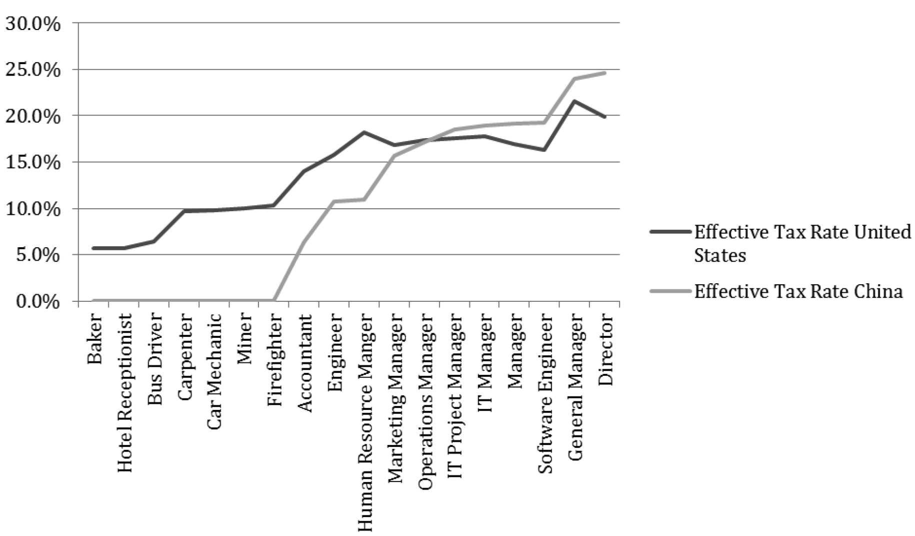
solution to this ongoing debate. Rather, my goal in this article is to show the similarities of the two systems on this issue.

V. CONCLUSION

The U.S. and China individual income taxes are both progressive tax systems that, in a broad sense, employ similar definitions of taxable and tax-exempt income. The Chinese tax seems more progressive in the sense that it exempts more of the lower income taxpayers overall and imposes a higher marginal rate on higher-income taxpayers as a result. Both systems employ preferences (in the form of lower marginal tax rates) for certain types of income, although the specifics for each tax differ. Arguments about the horizontal equity of each system can be made both for and against fairness. The arguments against the fairness of each system are largely based on the preferences it makes for certain types of income.

The comparison of the two individual income tax systems is interesting, although it is not complete. As I suggested at the beginning of this article,[142] China relies heavily on other sources of revenue for government funding, while in the U.S., nearly half of the federal government's revenue is from the individual income tax. An opportunity for additional research exists in a broader project that would compare the tax burdens of the entire tax system of each country, taking into account the other sources of government revenue and the burdens they impose on the citizenry.

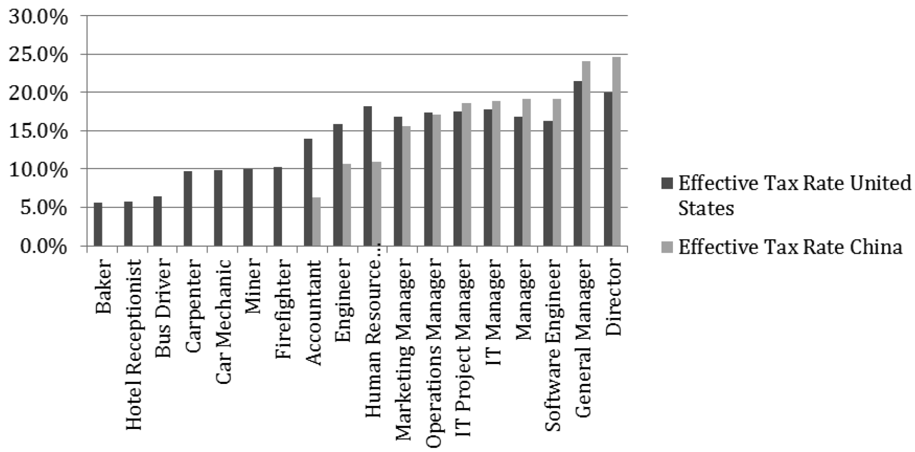
FIGURE 1



[142] *See supra* notes 1-2 and accompanying text.

34080-rgl_12-4 Sheet No. 16 Side A 11/14/2013 11:08:06

FIGURE 2


30.0%
25.0%
20.0%
15.0%
10.0%
5.0%
0.0%
Baker
Hotel Receptionist
Bus Driver
Carpenter
Car Mechanic
Miner
Firefighter
Accountant
Engineer
Human Resource...
Marketing Manager
Operations Manager
IT Project Manager
IT Manager
Manager
Software Engineer
General Manager
Director
Effective Tax Rate United States
Effective Tax Rate China

Appendix 1: Rate Schedules for Footnote 80

Married Individuals Filing Joint Returns and Surviving Spouses

If Taxable Income Is:	The Tax Is:
Not over $17,850	10% of the taxable income
Over $17,850 but not over $72,500	$1,785 plus 15% of the excess over $17,850
Over $72,500 but not over $146,400	$9,982.50 plus 25% of the excess over $72,500
Over $146,400 but not over $223,050	$28,457.50 plus 28% of the excess over $146,400
Over $223,050 but not over $398,350	$49,919.50 plus 33% of the excess over $223,050
Over $398,350 but not over $450,000	$107,768.50 plus 35% of the excess over $398,350
Over $450,000	$125,846 plus 39.6% of the excess over $450,000

Heads of Households

If Taxable Income Is:	The Tax Is:
Not over $12,750	10% of the taxable income
Over $12,750 but not over $48,600	$1,275 plus 15% of the excess over $12,750
Over $48,600 but not over $125,450	$6,652.50 plus 25% of the excess over $48,600
Over $125,450 but not over $203,150	$25,865 plus 28% of the excess over $125,450
Over $203,150 but not over $398,350	$47,621 plus 33% of the excess over $203,150
Over $398,350 but not over $425,000	$112,037 plus 35% of the excess over $398,350
Over $425,000	$121,364.50 plus 39.6% of the excess over $425,000

Unmarried Individuals (other than Surviving Spouses and Heads of Households)

If Taxable Income Is:	The Tax Is:
Not over $8,925	10% of the taxable income
Over $8,925 but not over $36,250	$892.50 plus 15% of the excess over $8,925
Over $36,250 but not over $87,850	$4,991.25 plus 25% of the excess over $36,250
Over $87,850 but not over $183,250	$17,891.25 plus 28% of the excess over $87,850
Over $183,250 but not over $398,350	$44,603.25 plus 33% of the excess over $183,250
Over $398,350 but not over $400,000	$115,586.25 plus 35% of the excess over $398,350
Over $400,000	$116,163.75 plus 39.6% of the excess over $400,000

MARRIED INDIVIDUALS FILING SEPARATE RETURNS

If Taxable Income Is:	The Tax Is:
Not over $8,925	10% of the taxable income
Over $8,925 but not over $36,250	$892.50 plus 15% of the excess over $8,925
Over $36,250 but not over $73,200	$4,991.25 plus 25% of the excess over $36,250
Over $73,200 but not over $111,525	$14,228.75 plus 28% of the excess over $73,200
Over $111,525 but not over $ 199,175	$24,959.75 plus 33% of the excess over $111,525
Over $199,175 but not over $225,000	$53,884.25 plus 35% of the excess over $199,175
Over $225,000	$62,923 plus 39.6% of the excess over $225,000