The Right of Deduction within the European VAT:

A Perspective for the VAT Reform in China

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Abstract

Value added tax (VAT), with its specific and unique feature as a neutral taxation, has spread rapidly around the world since its first adoption in Europe. China has also chosen to adopt VAT in an attempt to promote its economic development. In 2012, China started a new round of reform of VAT to extend its scope to industries which previously were liable to business tax. One of the most difficult problems is the rebuilding of the VAT deduction system therein. Although Europe faces its own problems and difficulties in the process of perfection and coordination of VAT, as the cradle of VAT it could still provide helpful insights for the ongoing VAT reform in China. Based on the analysis of the VAT system and, in particular, the right to deduct input VAT in Europe, combined with the development and special conditions of VAT in China, I propose several recommendations for the ongoing VAT reform in China and its future legislation. First, on the overall level, it is important to review the principle of neutrality in VAT, and rather than to view it as a natural result of the operation of the VAT system, its role as a rule to be complied with. Second, with regard to the design of the VAT deduction system, I argue that: (1) it is not necessary to establish VAT deduction as a substantive right of the taxpayer; (2) it is necessary to expand the scope of deductible items in China, especially in relation to fixed capital investment; (3) it is urgent to improve the treatment of the excess amount of deductible input VAT. Finally, suggestions are given supporting the construction of the related procedural legislation.

Key Words: Value-added Tax system, VAT Deduction, Right of Deduction, European VAT Directive, European Internal Market, Chinese VAT Reform, VAT Legislation
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