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VAT in Europe and China.

**A comparison and
main differences.**

**Major: Master of Business
Administration**

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1. Introduction

VAT is a turnover tax levied on goods' added value or value-added portion at various production, distribution, and labor stages. Since its birth, VAT has been highly valued and adopted by most countries and governments because of its inherent advantages and stable function to avoid double taxation to a certain extent. It is a universal and broad-based consumption tax. Currently, about 170 countries (regions) in the world use VAT as the major indirect tax, most commonly in the EU, where it applies to goods and services traded for use for consumption within the Union. VAT is also widely used in China and has become one of the most dominant taxes. ¹

This paper further analyzes the general differences and commonalities of the tax systems themselves by comparing and examining them based on the development and changes in the respective VAT in Europe and China. Through a comparative study, we can learn the successful experience of the EU tax system development and have practical and realistic significance for improving China's VAT modernization system and advancing the domestic VAT legislation process.

At the same time, through these general comparisons, combined with the different realities of the differences between the two sides, can we also ask more in-depth questions? For example, does the impact of VAT on the effectiveness of the tax system vary with the country system? Is there a direct or indirect relationship with the economic development of the country? Is it more pronounced in less developed economies? What leads individual countries (regions) to adopt (or not to adopt) VAT as a tax? How has the VAT changed in response to the changing vehicles of the modern economy? And so on.

¹ OECD. (2020), *Consumption Tax Trends 2020: VAT/GST and Excise Rates, Trends, and Policy Issues*[R], Paris: OECD Publishing.

2. The development process of VAT

In this section, we first give a brief overview of the VAT development process in the EU and China.

2.1 The development process of VAT in the EU

Background: At the time of the establishment of the EC², the initial six EU countries (Germany, Italy, the Netherlands, Belgium, and Luxembourg, among others) were using different forms of indirect taxes that would tax the actual value of production at each stage of the production process, making it impossible to determine the final effective tax amount and generating much avoidable double taxation. It is clear that if an effective single market is to be established in Europe, a relatively transparent and neutral turnover tax system is needed to ensure the neutrality and transparency of goods and services in the process of turnover.³

Looking at the process of change in the development of VAT in the EU over 50 years, it can be broadly divided into two phases.

a) Formative stage (1967-1992)

Around the time of the 1940s and 1950s, VAT was just some boring theory or specialized books. People might have heard of it, but they never really used it. The French government took the lead in a bold attempt to reform the sales tax system to a VAT system in order to take advantage of international trade and reduce the tax burden

² EC, or European Union. It was also known as the European Community during the period 1967-2009. The EU has officially abandoned the name of the system.

³ European Commission, "What is VAT?", Available online: https://ec.europa.eu/taxation_customs/what-vat_en.

in all aspects of production and distribution.

In 1948, France improved the Goods Tax (then also called excise tax) at the manufacturing stage to a method based on the value-added, which represents the birth of the VAT in France. In 1954, France advanced the VAT to the wholesale sector. At this stage, France levied VAT on the production operations of manufacturers and wholesalers. Still, it did not charge VAT on retail merchants and some independent businesses providing labor services, replacing them with a specific excise tax. It was not until 1968 that France gradually extended VAT to the retail segment, and eventually, in 1968, VAT was introduced nationwide. It took the French just over two decades to spearhead the conversion phase from a sales tax to a VAT system and rapidly enhance their own competitiveness in Europe and, indeed, in international trade. This reform process in France has had a significant impact on the rest of Europe, both positive and negative. In particular, other European countries had negative conflicts such as trade diversion effects, tax burden inequality, etc., due to the differences in tax systems between them. In order to resolve these conflicts, the European Economic Community (EEC) began to address these issues and led the remaining member states of the European Community to introduce VAT.

After several studies and consultations, the Community Commission published on April 11, 1967, the Directives I and the Directives II on the introduction of VAT.⁴ Concerning the harmonization of the laws of the Member States on the structure of business taxes and the rules for the application of the standard system of VAT, and decided that six Member States (France, the Federal Republic of Germany, Luxembourg, Belgium, Italy, and the Netherlands) must introduce VAT as of January 1, 1972. Since then, with the accession of Ireland, Denmark, the United Kingdom, Greece, Spain, Portugal and Greece, and later Sweden, Finland, and Austria (joined in 1995),

⁴ EUR-Lex, 67/227/EEC & 67/228/EEC.

the total number of EC countries has reached 16. At this stage, the EC countries were committed to removing tax barriers to allow more unrestrained movement of goods and products within the EC and create a single European market.

However, because different countries are based on various cultural and economic characteristics, plus the distinct attributes of finance history, thus deriving from the standard threshold of taxpayer registration, taxation scope, tax rates, Tax-free items, and other difficult-to-unify problems, which easily lead to conflicts and contradictions. This is a general reaction to historical, cultural, or social factors that determine to some extent the fiscal needs of each country. Because of the consistency, a great deal of discussion and coordination is required in each country before any legislation is adopted to determine a relatively fair and neutral tax system.

The EC issued the Sixth VAT Directive on May 17, 1977, which established a unified tax base, clarified the basic meaning of a consumption-based VAT, defined the scope of application of VAT, and extended it to all economic activities, among other aspects. This Directive has been amended several times before and after, but the primary purpose has not changed significantly. As the harmonized rules of European VAT, the Sixth Directive can be considered as the cornerstone and consignment of European VAT.

The EU tax law is an integral part of the EU legal system, reflecting the results of the EU development in the field of tax integration. Of course, up to now, the EU tax system is still a complex system with a large number of derived internal regulations within a similar overall concept.

During this period, the European Commission issued a series of effective decrees to harmonize VAT across member states and worked to eliminate tax borders.

b) Refinement Stage (1993 -)

In 1985 and 1987, the European Community made several proposals to eliminate fiscal borders, abolish border taxes, implement the territoriality principle, and unify VAT rates, but none of them were implemented. Until January 1, 1993, the Directive on " uniform rates of taxation as far as possible."⁵ It was implemented, which aimed to create a single market, improve the internal market, eliminate tariff barriers and fiscal controls between the Member States, place the Member States under a single standard rate framework, and set several rates and tax levels very close to each other.

The Directive provides for a minimum standard rate of no less than 15%, allowing for a reduction of one or two rates but no less than 5%. This Directive was initially set up as a transitional policy, but practical aspects in its implementation brought about some adverse effects. The increasing number of EU member states has since made it relatively difficult to implement some of the more harmonized ideas.

In 1997, the EU abolished VAT on imports and exports; in 1999, it introduced a low VAT rate of no less than 5% on a trial basis for some labor-intensive services.

In 2001, issues relating to electronic invoicing were regulated and harmonized. ⁶

In 2007, the member states agreed on the basic elements of the VAT system, and in terms of taxation, each member state provides for taxation at the point of sale of goods & supply of labor. In terms of rates, there is a standard minimum rate. One or two reduced rates can be used, with individual member states being able to use a lower rate

⁵ EUR-Lex, 92/77/EEC, Available online: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A31992L0077> (accessed on 31-10-1992).

⁶ EUR-Lex, 2001/115/EC, Available online: <https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A32001L0115> (accessed on 20-12-2001).

of three.⁷

At this stage, the EU was pushing for harmonization of VAT rates and administration, but coordination was complex. The replacement of the source principle with the purpose principle and establishing a single collection agency became the tax harmonization orientation of each EU member state. This phase was also a test of the EU's legal system and cohesion between member states.

In any event, the EU VAT is a pioneer and a forerunner in terms of the integrity and viability of the VAT system. To a large extent, it has provided experience and a reference point for the introduction and change of VAT in other countries.

2.2 The development process of VAT in China

Background: In 1978, China held a critical conference which established a strategic policy of reform and opening-up⁸. And following this conference, the state decided to gradually transform from the original single planned economy to a market economy. At the same time, the national turnover tax system mainly taxed industrial and commercial enterprises, which tended to lead to the problem of double taxation. In order to attract foreign assets, introduce advanced technology, actively open up to the outside world, and revive the domestic economy and promote economic specialization and reform, China urgently needed a powerful weapon capable of dealing with these problems.

China has undergone nearly forty years of reform and development, and the tax system has undergone several significant reform changes. They can be divided roughly into five stages.

⁷ COUNCIL DIRECTIVE 2006/112/EC, Article 98.

⁸ which can be summarized as a series of economic-oriented reform measures of "internal reform and external opening."

a) Introduction and exploration stage (1979-1982)

In 1979, drawing on the fruitful experience of VAT reform in many foreign countries, the state introduced VAT. The state took the tax reform as a breakthrough in the reform of the economic system by establishing a foreign-related tax system while promoting the reform of the domestic taxation system and reverting from a single tax to a composite tax adapted to the development of multiple economic modes. It also took the lead in conducting pilot and trial implementation in some cities and for a part of the industries, including industrial enterprises engaged in three categories of products such as machine and machinery production work, agricultural machinery, and daily-use machinery. 1982 saw the issuance of the Provisional Measures on VAT on the basis of the previous pilot.

b) Establishment and implementation stage (1984 - 2003)

In 1984, the relevant state departments promulgated the "Regulations of the People's Republic of China on Value-Added Tax (Draft)," which was introduced on a nationwide trial basis on October 1 of the same year, emphasizing the production sector and the export sector. This marked that VAT had officially become a new tax in China and formed a situation of coexistence with product tax and business tax, which were the significant taxes at that time. In January 1994, China has adopted a series of reform measures, including the nationwide reform of the tax division system, the extension of the levy to all industrial production (except real estate) and commercial circulation, the simplification, and consolidation of tax rate bands, and the division of taxpayers into general taxpayers and small-scale taxpayers, etc.

c) Transformation and Reform Stage (2004 - 2009)

Since the split tax system in 1994, China has basically established a production-type

VAT system. The object of this type of VAT is roughly equivalent to the GNP, therefore, in the process of collection, the production VAT can only deduct the tax on that part of the production materials belonging to non-fixed assets items and is not allowed to deduct the tax contained in the value of the fixed assets. The purpose of adopting this tax was also to stabilize the fiscal revenue. At the same time, under the macroeconomic background of China's inflated investment and overheated economy at that period, the adoption of production-based VAT also had a certain cooling and restraining effect.

However, with the economic development in the 21st century, both the international and domestic production and consumption situations have undergone drastic changes, more new contradictions and conflicts have been derived. Since July 1, 2004, China started the pilot VAT transformation. The reform of tax incentives mainly focused on six industries: equipment manufacturing, petrochemical industry, metallurgy, ship manufacturing, and military products, and high-tech industries in the northeast and central part of the country. Subsequently, on July 1, 2007, the relevant departments tried to increase the power industry, excavation industry, and other industries in some other old industrial urban areas to expand the scope of input tax deduction. On January 1, 2009, the State implemented the newly revised Provisional Regulations on Value Added Tax (VAT) and introduced the VAT transformation reform in all regions and industries across the country. This measure reduced the burden on enterprises and laid the foundation for the future transition to a consumption-based VAT.⁹

d) Full-scale implementation phase (2012 - 2016)

Expanding the scope of VAT collection, eliminating the phenomenon of double taxation of business tax, and promoting the development of the tertiary industry became one of

⁹ Provisional Regulations on VAT (PRC) (2008)

the directions of China's VAT transformation and reform in this phase.

Starting from January 1, 2012, China took the lead in carrying out pilot projects to deepen the reform in the transport sector and some modern service sectors in Shanghai. In 2014, the pilot projects were extended to the national railway transport sector and postal sector. From May 1, 2016, the scope of the pilot reform was extended to the construction, real estate, financial, and household services sectors. The VAT is included in the range of the deduction for all enterprises' new real estate. At this stage, full nationwide coverage of VAT across all sectors was achieved through pilot projects and adjustments, and the business tax has since stepped out of the historical stage.

e) Deepening reform phase (2017 -)

After a series of pilot reforms, China's VAT has gradually transformed from a production-based VAT to a consumption-based VAT and started to enter the finalization and legislative stage at this stage. However, the problems of complex tax rate brackets and unreasonable structure of tax concessions still exist, and there is still a gap with the ideal modern tax system. Thus, the State Council has taken a series of measures to promote the structural reform on the supply side by lowering the tax rate brackets, unifying the standard for small-scale VAT payers, and refunding the retained tax credits of some enterprises.

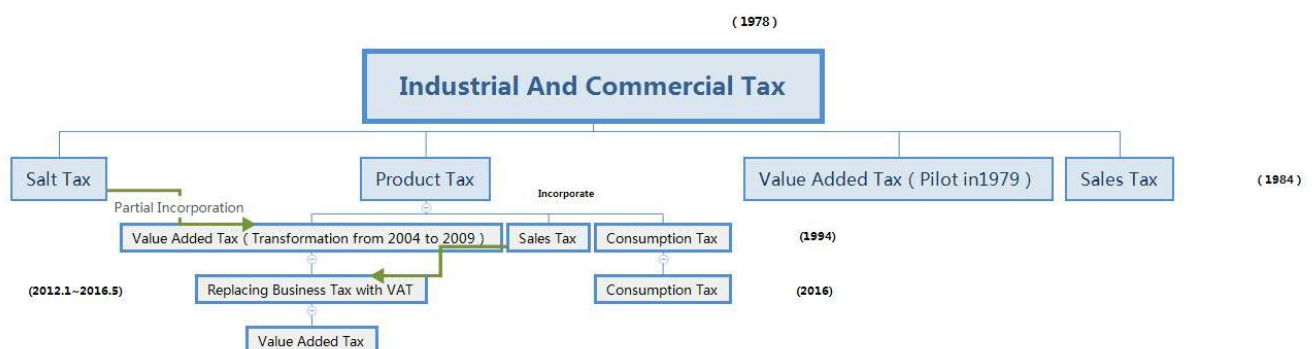


Chart 1 The Evolution of VAT in China

China's VAT reform can be said to have drawn on the best of the reform process in other countries around the world (especially the EU's VAT), drawing on many successful experiences while making adjustments and adaptations to actual national conditions. The leading tax in China has gone through a process of change from industrial and commercial tax, product tax, and then VAT, which in turn has changed from a production-based to a consumption-based tax. With the continuous improvement of the leading tax and the gradual expansion of tax coverage, it was possible to solve the problems of imbalance in the economic structure, double taxation, and incomplete VAT deduction mechanism caused by the coexistence of business tax and VAT in a relatively short period of time, and to facilitate the maximization of the functions and efficacy of VAT

3. Comparisons and main differences

This section presents a specific comparison and analysis of the development of VAT formation and general factors such as tax rates, taxable scope, etc., in the EU and China. Before comparing the various aspects of both, we must first clarify the respective range of VAT applications.

EU VAT applies to the purchase of domestic goods, community goods, and imported goods in the territories of EU member states and other countries that comply with EU VAT rules. At the same time, some countries and regions outside the EU have also become part of the European Union Customs Union by signing customs conventions and other rules with the EU. These include Monaco and the British Overseas Territories of Akrotiri and Dhekelia. For example, the Franco-Monegasque agreements signed between Monaco and France in 1963 and 2003, respectively, provide for Monaco to comply with French collection rules with the same basis and the same tax rate. As a

result, Monaco becomes part of the EU VAT.¹⁰ In addition to this, the EU has established customs unions with Andorra, San Marino, and Turkey (excluding some products) through separate bilateral agreements.

Of course, although all EU members are part of the customs union, not all territories are subject to taxation. Some regions of certain member states are usually excluded from the collection area for historical, tax, or geographic reasons. These areas are mostly geographically separated and include enclaves or overseas territories, such as the Spanish dependencies of Ceuta and Melilla in Africa, which enjoy VAT-free status. They also include islands or waters, such as the German archipelago of Heligoland in the North Sea and the Italian waters of Lake Lugano.¹¹ The scope of application of VAT is constantly changing in line with the changing membership of the EU. It has tended to stabilize in recent years.

It is worth mentioning that, in the official terminology, the territory of the People's Republic of China, in terms of its sovereignty, includes mainland China, the two Special Administrative Regions of Hong Kong and Macau, and, of course, Taiwan. However, due to the country's particular system and historical legacy, the two Special Administrative Regions and Taiwan have relatively complete legal systems. They are separate legal regions, which are usually treated as other regions to deal with tax issues separately. Under the Provisional Regulations of the People's Republic of China on Value-Added Tax, tax liability arises only when the "taxable activity" occurs in the territory of the People's Republic of China or when the taxable goods and services enter the territory of the People's Republic of China.¹²

¹⁰ Monaco and European Union, Available online: <https://en.gouv.mc/Policy-Practice/Monaco-Worldwide/Monaco-and-the-European-Union>

¹¹ COUNCIL DIRECTIVE 2006/112/EC, Article 5-7

¹² Provisional Regulations on VAT (PRC) (2017), Article 1

Therefore, the definition of "within the People's Republic of China" for tax purposes mentioned below does not include the two Special Administrative Regions and Taiwan, but only the scope of mainland China.

3.1 National System

First of all, there are obvious differences between EU countries and China regarding state and economic systems. The countries of the EU are generally defined as capitalist countries. Although after decades of economic and social development, China is still essentially a socialist country, with the idea of socialism with Chinese characteristics as the main guiding ideology.¹³

3.2 Degree of economic development

Second, in terms of the level of national development, most of the EU countries have extremely high social productivity and a high standard of living for their inhabitants. However, China announced in 2021 that it had built a moderately prosperous society,¹⁴ Absolute poverty has been completely eradicated. But due to population density and some constraints, this relative lag in productivity levels still exists in some regions and is still defined as a developing country.

The economic foundation determines the superstructure. As a developing country, China is constrained by the total economic volume, the level of economic efficiency, and management ability; it is fundamentally determined that the scale of its tax revenue

¹³ This ideology is based on Marxism and changed according to China's national conditions.

¹⁴ Moderately prosperous society: It refers to the state of relative affluence achieved by development, first proposed by then-President Deng Xiaoping in 1979. The term "moderately well-off" is defined by the FAO's criteria for the stage of life development, with an Engel coefficient of 40%-50%.

cannot be too large. To significantly increase the level of tax burden requires a continuous process.

3.3 Purpose and background of the introduction of VAT

As can be summarized from the statements in Part II, the EU was founded on establishing a single market with a focus on the internal governance of the economies. Therefore, after the emergence of conflicts in some European countries in the last century due to imbalance in trade taxation and trade conflicts caused by double taxation, the member states of the European Community introduced VAT and systematically regulated matters such as VAT payers, taxable values, tax bases, and tax rates, which strengthened the simultaneous coordination of the tax elements of the member states and safeguarded the interests and development of each member state. It can also be said that the EU's VAT system is a manifestation of fairness and protection for the EU member states.

The introduction and implementation of China's VAT are based on the need to reform the internal economic system and opening up to the development of a market economy. Especially after China acceded to the WTO in 2001, the VAT reform also needs to be in line with international standards. This can be said to be a relatively passive situation and also a bold choice by China. The introduction and reform of VAT have prompted the structural transformation and upgrading of China's production industries, utilizing measures such as the gradual consolidation and abolition of business taxes to stimulate market dynamics and promote the formation of a level playing field in the market.

3.4 Stages of VAT development

Most EU member states in general introduced and implemented VAT earlier than China

due to the EU's requirements for membership. And if a country wants to become a member of the EU, it presupposes that it meets the conditions for membership, including the implementation of the financial and taxation directives. In order to establish an economic community, the main task of the EU is to remove various institutional barriers, including surcharges, so that tax disputes and strife that already exist or may arise can be resolved to the greatest extent possible. Therefore, even if the member states may not meet the corresponding standards at the time of accession, the EU will give negotiating room and help each member state to achieve tax convergence in the shortest possible time.




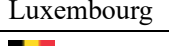

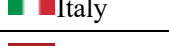
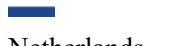
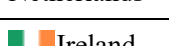
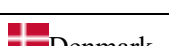




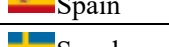
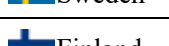
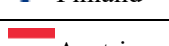
As previously mentioned, the EU is currently seeking to establish a more complete and unified European market. With the framework of tax-related directives and regulations basically completed, some specific tax policies will be improved according to the actual situation. Union will strive to create a favorable economic development environment for the member states and enhance the overall competitiveness so as to achieve win-win cooperation among the member states.

After more than 40 years of development, China's VAT completed the pilot reform of all four major industries on May 1, 2016, which marked the complete replacement of business tax by VAT. From the start of the pilot in 2012 to the final completion of full coverage of all sectors in 2016, China took five years, almost 15 years less than France. Of course, the period from the introduction of VAT in 1979 to the completion of the replacement of business tax by VAT was 38 years of coexistence of business tax and VAT, which is again far longer than France.

Long before the introduction of VAT in China, France was the first to complete the process of replacing business tax with VAT, which to a certain extent alleviated the burden caused by the drawbacks of double taxation. However, it took until 2016 for

China to complete this transition. This shows that China promoted the development of VAT while taking into account both the conditions of collection and administration as well as the fiscal affordability at that time. For now, China has only completed the pilot, and the subsequent work on the relevant institutional solidification and tax legislation will require the continuous attention of the authorities and tax practitioners.

3.5 General elements of taxation

Jurisdiction	Implementation time	Rate (%)		Taxation scope	Time of accession to the EC or EU
		Standard	Reduced		
 France └ Monaco	1968	20%	10%, 5.5%, or 2.1%	Agriculture Industry Wholesale Retail Services	Six countries at the beginning of the EC
 Germany	1968	19%	7%		
 Luxembourg	1970	17%	14% ,8% or 3%		
 Belgium	1971	21%	12% or 6%		
 Italy	1973	22%	10%, 5%, or 4%		
 Netherlands	1969	21%	9% or 0%		
 Ireland	1972	23%	13.5%, 9%, 4.8% or 0%		1973
 Denmark	1967	25%	—		
 Greece	1987	24%	13% or 6%		1981
 Portugal └ Azores └ Madeira	1986	23% └ 18% └ 22%	13% or 6% └ 9% or 4% └ 12% or 5%		1986
 Spain	1986	21%	10% or 4%		
 Sweden	1990	25%	12% or 6%		1995
 Finland	1990	24%	14% or 10%		
 Austria	1973	20%	13% or 10%		
 Czech Republic	1993	21%	15% or 10%	Industry, wholesale, retail, services	2003
 Estonia	1994	20%	9%		

Continue to the above chart...

Jurisdiction	Implementation time	Rate (%)		Taxation scope	Time of accession to the EC or EU	
		Standard	Reduced			
Hungary	1988	27%	18% or 5%			
Latvia	1992	21%	12% or 5%			
Poland	1993	23%	8% or 5%			
Slovakia	1993	20%	10%			
Slovenia	1999	22%	9.5%			
Lithuania	1994	21%	9% or 5%			
Malta	1992	18%	7% or 5% or 0%			
Cyprus & Akrotiri & Dhekelia	1992	19%	9% or 5%			
Romania	1993	19%	9% or 5%			2007
Bulgaria	1994	20%	9%			
Croatia	1998	25%	13% or 5%	Some agriculture, industry, wholesale, retail, services	2013	

Chart 2 VAT systems in EU member states¹⁵¹⁶

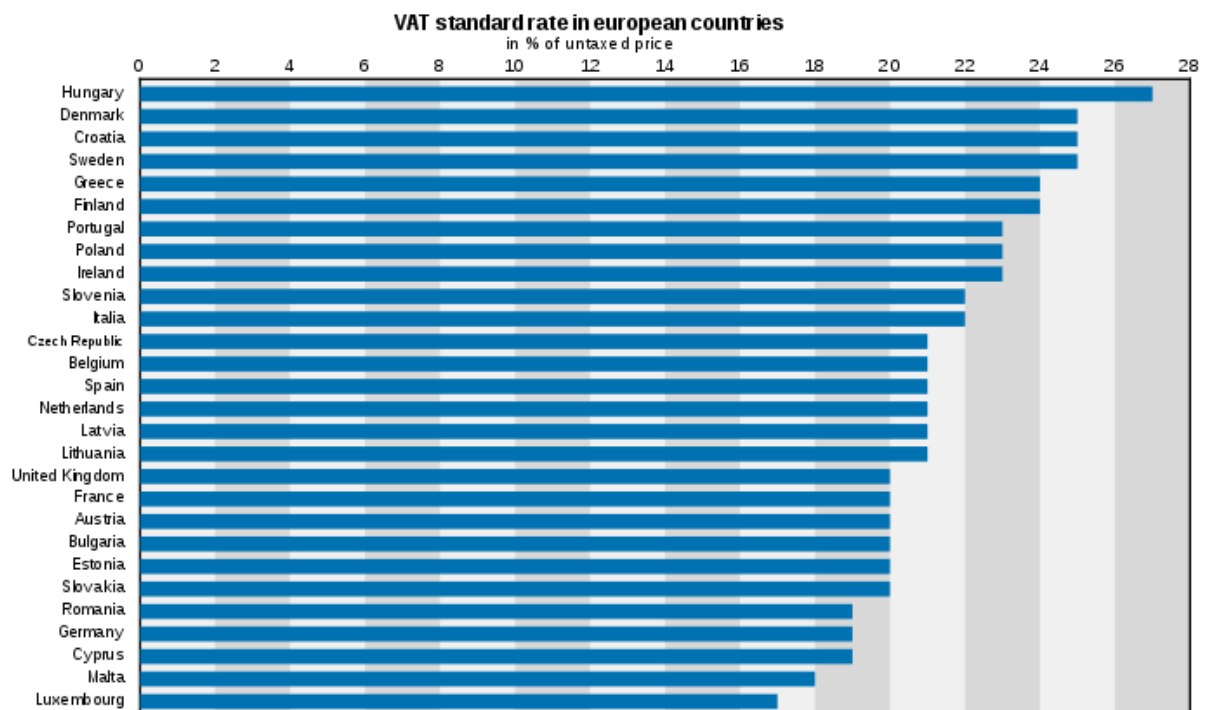


Chart 3 Standard tax rates for each EU member state (%)

¹⁵ The chart is based on the IBFD online database and the Wikipedia entry for EU VAT.

¹⁶ Greece joined the EC in 1981, but for various reasons, the government applied for several delays in the introduction of VAT, which was officially introduced in 1987.

The chart above shows that most EU countries have opted for multiple tax rates, with the standard tax rate ranging from 17% - 27%, averaging 21.5%. Within all countries of the European Union, Hungary has the highest standard tax rate, and Luxembourg has the lowest standard tax rate. On the other hand, the UK has officially launched the EU in a referendum in 2020, so the UK tax rate will not be of the reference value.

Among the EU member states alone, the more industrialized countries have higher tax rates than the less developed countries, but this is not related to the time of accession to the EU or the level of GDP.

Subject	Standard Rate	Tax bracket	Taxation scope	Tax-free items	Subject of taxation
European Union	21.5% (Average)	2-3 levels in most member countries, but also 4-5 levels in some	<ol style="list-style-type: none"> 1. 15 old EU member states apply agriculture, industry, Retail wholesale trade, services 2. 12 new EU Member States apply industry, wholesale trade, retail trade, services (excluding agriculture) 3. Croatia applies partially to agriculture, industry, wholesale trade, retail trade, services 	Mainly concentrated in finance, real estate, health care, social welfare, education, culture, sports and services, postal services and supplies, lottery, gaming services, etc.	With the exception of countries such as Spain and Sweden, most countries are divided into the general taxable person and small taxable person based on registration thresholds and starting points. Some countries do not require registration or taxation for the small taxable person, but some countries require registration, although not taxation. A special taxable person may benefit from tax exemptions or be taxed at the levy rate.

Chart 4 General elements of VAT in the EU¹⁷

Subject	Standard Rate	Tax bracket	Taxation scope	Tax-free items	Subject of taxation
China	13%	13%, 9%, 6%	<ol style="list-style-type: none"> 1. Sale of goods, services, rental services of tangible movable property, or import of goods. (13%) 2. Sale of transport, postal, basic telecommunications, construction, real estate rental services, sale of real estate, transfer of land use rights, or sale or import of some goods within the regulations. (9%) 3. Sales of services, intangible assets. (6%)¹⁸ 	<ol style="list-style-type: none"> 1. Home-grown agricultural products sold by agricultural producers 2. contraceptive drugs and instruments 3. antique books 4. imported instruments and equipment directly used for scientific research, scientific experiments, and teaching 5. imported materials and equipment provided by foreign governments and international organizations without compensation 6. goods for the disabled 7. sale of used products¹⁹ 	<ol style="list-style-type: none"> 1. General taxable person, subject to different tax rates. 2. The General taxable person for specific taxable acts, subject to a 5% levy rate. 3. small taxable person, subject to a levy rate of 3%

Chart 5 General elements of VAT in China²⁰

¹⁷ The chart is compiled from the IBFD online database.

¹⁸ Provisional Regulations on VAT (PRC) (2017), Article 2.

¹⁹ Provisional Regulations on VAT (PRC) (2017), Article 15.

²⁰ This chart is compiled Provisional Regulations of the Provisional Regulations on VAT (PRC) (2017).

As can be seen from the table above, the general differences in VAT between China and the EU are mainly reflected in:

a) Different definitions of taxable persons

In the EU, a taxable person is a person who independently carries out economic activity, which is defined in a wide range of occupations, including producers, services, etc. He is the one who must pay taxes. If a public institution operating in telecommunications, gas, electricity, transportation, etc., carries out business activities as an entrepreneur, it needs to be treated as a taxpayer. All persons, including producers and consumers, are liable to pay taxes on imported products. Of course, there are many exemptions within the EU, such as the purchase of goods between EU member states are not subject to taxation, but not including illegal drugs, counterfeit currency, etc.

In all other cases, a private consumer is not a taxable person. But the trader with whom the transaction arises is legally subject to tax and must pay it (even if he passes it on to the final consumer). At the same time, economic activity begins with investment expenditures. Therefore, a pure holding company should not be considered a taxpayer.

²¹

Under the Chinese VAT system, there is a definition of "taxable activity," a concept that includes economic and investment activities in a broad sense and generally corresponds to the EU concept of "economic activity."

In China, both entities and individuals who generate goods or services and import goods in China are defined as VAT payers. The units here include public institutions, administrative agencies, enterprises, military units, social organizations, and other

²¹ COUNCIL DIRECTIVE 2006/112/EC, Article 9-13

entities; individuals refer to natural persons or also include individual entrepreneurs. Therefore, whether a unit or an individual is taxable depends on whether it is within the scope of "taxable activity", not on whether the supply is a public institution or a private enterprise.

Since there is no conceptual division of holding companies in China, it is also understood that if one does not participate in the operation or management of the company in which the interest is held, it will not be classified within the scope of the levy. In general, interest on deposits and insurance payouts received by the insured are not included in the VAT collection. In respect of these types of transactions, the Chinese administration is similar to the rules governing VAT in the EU.

b) Different tax rates and tax brackets

Unlike the EU, which is an economic and political union of 27 European countries, China's legal system is primarily uniform at the national level, with local regulations only being able to make limited changes within the framework of a limited tax system. In contrast, the EU VAT system sets a minimum standard, and individual member states can specify basic rates and bands within the range according to their own national economic and political situation.

Currently, the standard tax rate in China is 13%, and the average standard rate in the EU is 21.5%, compared to the standard rate in China, which is 8.5 points lower than the EU.

In the face of an increasingly complex and competitive international economic situation, and the internal need to accelerate integration, the EU has also seen a gradual trend towards harmonization in constructing its tax system. The EU proposed the reform of a single VAT area in 2017 and plans to start its operation in 2022. Although the

Commission is gradually trying to run a single VAT area, the effectiveness of this area still cannot override the tax policies of individual member states. At the same time, due to the instability of the world economy, some member countries are increasingly relying on the tax function of VAT in order to protect their fiscal revenues and mitigate the impact of changes in the government's budgetary position and are constantly postponing plans to reduce or increase the initial VAT rate.

On April 19, 2017, an executive meeting of the State Council decided to reduce the VAT rate from four brackets to three brackets with effect from July 1, which is the first step in the reform of simplifying and merging the VAT rates in China. Most of the tax brackets in the EU are decided by countries according to their national conditions, with the EU directives serving as a norm and reference, so the tax brackets are mostly different from country to country. With the exception of Denmark, which has a single tax rate, most member states have 2-3 tax brackets. Some countries also have 4-5 different tax brackets.

c) Different scope and chain of application of tax rates

The range of tax rates applied in the EU countries is broadly similar, with each member state having a different choice. Most of them are concentrated in sectors such as agriculture, industry, wholesale, retail, and services. The scope of application of low tax rates is mostly focused on household goods such as food, beverages, electricity, water, and gas, including products and services for cultural exchange such as tourism, accommodation, and transport. The zero-tax rate is mostly for prescribed goods transactions and services, and the scope includes international transportation, books, and newspapers, foodstuffs, etc. Exemptions are concentrated on finance, real estate, health care, social welfare services, culture, education, postal services, etc.

The low-rate VAT is set to meet basic livelihood needs and includes some social welfare

and public service sectors. Of course, it includes items like finance and real estate that are difficult to estimate the tax amount and relatively complex.

The scope of taxation in China is focused on the sale or import of goods, processing, repair, and assembly services, various services as specified, transfer of financial instruments, sale of intangible assets, transfer of land use rights, etc., sale of immovable property, etc. The scope of the zero ratings is concentrated on exports of goods, entry, and exit of passengers and goods, transportation of space services, as well as services such as research and development, energy management, design, software, and information systems that are consistent with consumption outside of China.

As illustrated in Chart 4, the scope of tax exemptions is concentrated in seven main categories. Because China's previous VAT reform, which incorporated some of the former business tax exemptions into the VAT exemptions, made the tax exemptions too complex, narrow and fragmented in scope.

A major focus of China's VAT reform in 2016 is to bring the tax area to full coverage of all areas and sectors of goods and services. At the same time, three new categories of construction services, financial services, and living services have been added to the scope of the levy, thus realizing the connection and extension of the VAT chain to various economic fields.

The focus of the levy on financial services includes some loan services, direct fee financial services, insurance services, and financial services such as transfer of financial goods and transfer of intangible assets. The scope of financial services and commodities exempted from VAT is also clearly expanded. For example, small loans, national student loans, national bonds, and local government debts can enjoy tax exemption. ²²

²² VAT Tax Policy Guidelines for the Financial Sector,

EU countries do not include certain financial goods and financial service delivery industries in the scope of VAT for various considerations. Of course, there is a general controversy in the financial community over such products, and an income tax or capital gains tax is generally used to regulate capital investment behavior.

d) Difference between taxpayers and tax thresholds

Under the Chinese VAT system, there is a definition of a "Starting Point," which generally corresponds to the concept of a "registration threshold" in the EU. Most countries in China and the EU, with the exception of Italy, Spain, and Greece, have a threshold, but there are significant differences in the criteria used to determine it.

In the EU, almost every country implements a different standard tax threshold. Some of them follow this same tax threshold, but with some adjustments in some parts due to various reasons such as economic activity, tax conditions, and economic development. For the EU, the tax thresholds are a relatively complex presentation.

The following chart summarizes and sorts out the different thresholds for each country in different situations.

Available online: http://beijing.chinatax.gov.cn/bjswj/c104329/201906/t20190624_388423.shtml (accessed on 30-03-2016).

Member State	The threshold for application of the special scheme for acquisitions by taxable persons not entitled to deduct input tax and by non-taxable legal persons		The threshold for application of the special scheme for distance selling		Exemption for small enterprises	
	National currency	Euro equivalent	National currency	Euro equivalent	National currency	Euro equivalent ⁴
Belgium	€11 200		€35 000		€25 000	
Bulgaria	BGN 20 000	€10 226	BGN 70 000	€35 791	BGN 50 000	€25 565
Croatia	HRK 77 000	€10 410	HRK 270 000	€36 501	HRK 300 000	€40 557
Czechia	CZK 326 000	€12 795	CZK 1 140 000	€44 744	CZK 1 100 000	€39 250
Denmark	DKK 80 000	€10 717	DKK 280 000	€37 510	DKK 50 000	€6 698
Germany	€12 500		€100 000		€17 500	
Estonia	€10 000		€35 000		€40 000	
Ireland	€41 000		€35 000		NA	
Greece	€10 000		€35 000		€10 000	
Spain	€10 000		€35 000		None	
France	€10 000		€35 000		€82 800 or €42 900 or €33 200	
Italy	€10 000		€100 000		€65 000	
Cyprus	€10 251,61		€35 000		€15 600	
Latvia	€10 000		€35 000		€40 000	
Lithuania	€14 000		€35 000		€45 000	
Luxembourg	€10 000		€100 000		€30 000	
Hungary	€10 000		€35 000		HUF 8 000 000	€24 775
Malta	€10 000		€35 000		€35 000	
Netherlands	€10 000		€100 000		None	None
Austria	€11 000		€35 000		€30 000	
Poland	PLN 50 000	€11 785	PLN 160 000	€37 712	PLN 200 000	€47 140
Portugal	€10 000		€35 000		€10 000	
Romania	RON 34 000	€7 291	RON 118 000	€25 305	RON 300 000	€47 180
Slovenia	€10 000		€35 000		€50 000	
Slovakia	€14 000		€35 000		€49 790	
Finland	€10 000		€35 000		€10 000	
Sweden	SEK 90 000	€8 535	SEK 320 000	€30 346	SEK 30 000	€97 741

Chart 6 VAT THRESHOLDS (1 JULY 2019)²³

²³ Organized according to European Commission, “Where to tax?”
(Available online: https://ec.europa.eu/taxation_customs/where-tax_en)

In China, according to the threshold of annual taxable sales of 5 million RMB (around 650,000 euros), taxpayers are divided into general taxpayers and small-scale taxpayers.

There are also some specific differences between these two types of taxpayers, as shown in the chart below.

Subject	General taxpayer	Small taxpayers
VAT sales	Annual VAT assessable sales > ¥5,000,000	Annual VAT assessable sales ≤ ¥5,000,000
Rate	Applicable 13%, 9%, 6%, 0 tax rate	Applicable 3% tax rate ²⁴
Invoice	Sales of goods can be issued with VAT invoices, and purchases of goods can be issued with special VAT invoices.	Purchased goods are not deductible for input tax
Financial Processing	The price portion is charged to cost, and the tax portion is credited to the "Taxes Payable - VAT Payable - Input Taxes" account.	Cost at the full amount
Taxable amount	According to the projects operated to account for the amount of tax payable, if operating projects with different tax rates, different tax amounts should be accounted for separately according to different tax rates, and if not separately, the higher tax rate will apply. ²⁵ There are different calculation methods according to different situations.	Sales*Tax Rate ²⁶

Chart 7 Definition of different types of taxpayers²⁷

²⁴ Provisional Regulations on VAT (PRC) (2017), Article 12.

²⁵ Provisional Regulations on VAT (PRC) (2017), Article 3.

²⁶ Provisional Regulations on VAT (PRC) (2017), Article 11

²⁷ Organized according to Provisional Regulations on VAT (PRC) (2017)

Unlike the relatively complex VAT thresholds in the EU, the thresholds in China are relatively simple and clear. According to a standard to divide into taxpayers and small-scale taxpayers, two different types of tax subjects, and then within each type of tax requirements are refined and applied to different tax rates and situations.

On the contrary, the coexistence of multiple taxation thresholds in the EU is a suitable choice for the current situation and nature of the Union, which can make the taxation process more accurate and detailed and can avoid various loopholes arising from the ambiguity of taxation.

e) Differences in VAT policy and administration

In order to eliminate tax borders, play the more actively characterize "neutral" role of taxation. Since 1993, the European Union has issued a series of directives that provide tax rebates for enterprises both inside and outside the EU, including labor and services. EU countries have developed a relatively good control system in the areas of cash management, electronic invoicing, third-party information, tax checks, and handling of tax disputes. In particular, the EU has also taken the lead in implementing a series of practical measures to deal with various digital (cross-border) transactions and other situations that have arisen in the global digital economy. These include adjusting the tax rates applicable to e-books, enacting the Regulation on the Implementation of the VAT Reform for Electronic Commerce.²⁸ And imposing VAT on cross-border digital products or electronic services. Mechanisms such as taxation at the place of consumption or reverse tax are used when traditional taxation methods cannot identify the location of origin or permanent establishment.

²⁸ IBFD. European Union: Amendment of VAT Implementing Regulation Regarding E-commerce: Published[N]. *News IBFD*, (accessed on 04-12-2019).

Although the EU countries are homogenizing their tax systems, there are still difficulties coordinating and administering them because the individual countries themselves run the administrations.

China is similar to the EU in the way VAT is administered, but there are still some gaps in some aspects of control. For example, at present, China only refunds taxes on exported goods. At the same time, other similar services or services do not have a class policy for the time being, which to a certain extent also affects the EU's trade with China.

Although China also has a tax control by invoice approach and has developed a regulatory system, it is still somewhat lacking in other areas. For example, China's tax administration capacity is not compatible with the tax reform. It is subject to compartmentalization, with different agencies collecting and administering in other parts of the country and lacking a coordination mechanism between state and local taxes. The current VAT administration has many layers and intermediate links, which is not conducive to the overall function of the tax administration.

4. Recent Development Trends

4.1 Continuing effects of Covid-19

In recent years, the number of countries that have introduced VAT has continued to increase, and the standard rate of VAT has remained the same in most countries (regions). Some individual countries have made some adjustments to the standard rate for some reasons. However, due to the influence of covid-19, these adjustment measures have not been implemented.

Some countries intend to increase the standard rate of VAT, like Italy. Italy originally

planned to increase the standard VAT rate to 25% in 2021 from the previous 22%, raising the reduced rate of 10% to 12%. In order to ease fiscal pressure, Italy also further plans to increase the standard rate to 26.5% in 2022. But in early 2020, COVID-19 spread worldwide. Affected by COVID-19, Italy finally announced the cancellation of the program. The original tax structure will continue to be maintained.

Of course, some countries want to motivate VAT further and plan to reduce the original rate. For example, Poland originally planned to reduce the original standard rate of 23% to 22% in 2021, with one of the lower rates reduced from 8% to 7%. However, the impact of COVID-19 continues to grow on individual countries, leading to a significant increase in the country's fiscal deficit, and the Polish government has also decided to postpone this downward reform measure in order to stabilize the country's fiscal revenues.

In order to cope with the huge impact of the epidemic on national economies, governments around the world have introduced tax policies. As an example, during the outbreak period, the devastating impact of the epidemic led to a series of economic activities coming to a near halt, and countries announced and implemented tax deferral policies of different lengths; in early 2020, as the eye of the COVID-19 storm, the Chinese government and people immediately calmed down after experiencing a brief panic in the face of the unknown and introduced a series of protective measures to protect the normal production of some key enterprises, which included a series of measures such as stipulating that manufacturers of key protection materials for epidemic prevention and control could apply for a full refund of VAT; Norway to passenger transport, hotel accommodation, and other industries hit by the epidemic to temporarily reduce the tax rate from 12% to 6% at last.²⁹; Belgium to part of the

²⁹ IBFD. Norway: COVID-19 Pandemic: Norway Plans to Extend Application of Reduced 6% VAT Rate[N]. *News IBFD*, (accessed on 18-11-2020).

epidemic prevention supplies applicable tax rate from the original 21% to 6%³⁰; Greece to the production and sales of epidemic prevention goods of some enterprises of the applicable tax rate from the original 24% down to 6%³¹. And other critical and practical measures. Other countries (regions) have also made similar provisions to maintain the basic needs of the population. These VAT-related measures have played an essential role in epidemic prevention and control, stabilizing the economy and safeguarding people's livelihood.

In other words, nearly a year and a half have passed since the outbreak of coronavirus disease in 2019 from individual regions to global epidemics and then to continuous spread. People are getting used to the "disastrous" impact of this huge pandemic virus and are looking for a different way of life and work. The economy of some countries that rely on import, export, and tourism has been impacted to varying degrees, which also requires the governments of various countries to adjust the implementation strategies according to the actual situation so as to make the value-added tax play a role in time and stabilize the future economic situation.

4.2 The continued development of economic globalization

In the context of economic globalization, especially in recent years, the fourth industrial revolution and digital information revolution, with the normalization of social media, e-commerce, online education, and other industries, digital enterprises have become dominant in specific industries. Of course, these industries, which are more mobile and rely on data and networks, do not apply the same tax rates as traditional forms of products, and to some extent, are more likely to breed tax evasion and avoidance. Such

³⁰ IBFD. Belgium: COVID-19 Pandemic: Belgium Proposes Extension of Reduced 6% VAT Rate for Face Masks and Alcohol Gel[N]. *News IBFD*, (accessed on 08-12-2020).

³¹ IBFD. Greece: COVID-19 Pandemic: Emergency Tax Measures – Reduction of VAT Rates for Certain Products[N]. *News IBFD*, (accessed on 06-04-2020).

digital changes also pose specific challenges for tax administration.

In order to counteract some of the fraudulent practices that occur in VAT, the European Commission is actively proposing measures for improvement.

For example, the adoption of a new collection mechanism. The adoption of a reverse VAT collection mechanism, which converts the supplier's obligation to pay VAT returns to the consumer, is used to address the problem of non-compliance with the supplier's obligation to pay VAT after an inbound transaction has taken place. The reverse levy mechanism is widely used in EU member states, and this mechanism has also achieved some success. It is mainly used in the sale of electronic equipment, gas and electricity sales, construction work, waste recycling, etc.

For example, a new information exchange system was introduced to create a "Transaction Network Analysis" (TNA) ³²System to combat cross-border tax evasion and avoidance. The system identifies potential VAT fraud by analyzing transaction activity, comparing vendor sales and purchaser information, and comparing it with data reported in VAT returns. The information collected is also shared with member countries to enable swift joint action. At some point in the past, it has been difficult to find fraudsters across borders for technical or other reasons. This system can help combat VAT fraud and be a good solution to the historical legacy of not being able to find fraudsters. The application and practice of this system will help in the fight against VAT fraud.

One more example, the establishment of a "Central Electronic Payment Information" (CESOP) system and the establishment of the "supranational" data storage system, etc.

³² Terra & Kajus. New Tool to Help Member States Crack Down on Criminals and Recoup Billions[N]. *News IBFD*, (accessed on 20-05-2020).

All these measures have further strengthened the cooperation and connection among EU countries, and the EU has taken a big step forward in the governance of anti-tax evasion. In this aspect of anti-avoidance institution building, China still has a lot to learn and improve.

5. Prospects

All in all, both the EU and China have gone through a process of adaptation and improvement of VAT and have basically worked out a VAT system that meets the actual situation and is suitable for their own tax system areas. Nevertheless, there are still some loopholes that are worth exploring and upgrading in the future.

5.1 Coordination trends in the EU

In the future, the EU may continue to try to coordinate the tax rates of average member states stably while simplifying and reducing the tax rate level.

At the same time, adjust and expand the scope of levy in the future to make the chain of levies more complete, including items to which zero-rate and exemptions apply. Consider speaking about those banking, insurance, and leasing industries that are not included in the scope of VAT levy to be governed on a case-by-case basis and by degree, under established and appropriate circumstances.

In the age of the global digital economy, the EU can continue to improve and strengthen existing information management systems while exploring in greater depth effective mechanisms for the management of e-commerce. At the same time, in view of a large

number of member states and the difficulty of management, the EU can also deepen the supranational body for coordinating the tax affairs of member states, which is used to regulate the tax behavior of member states and coordinate the collection and administration outside the jurisdiction, following the differences in procedural rules and the principle of "neutrality" to realize taxation without borders truly.

5.2 Coordination trends in China

VAT is a neutral tax, and it is reasonable to avoid the negative effects such as the disruption of economic activities and the increase of government administration costs brought about by the increase of VAT. Therefore, China needs to continue to adjust and optimize the VAT rates and brackets in the future and appropriately reduce the tax rates so as to reduce the cost of paying taxes and improve the efficiency of using VAT.

China's VAT can also further integrate the scope of tax exemptions by including the more common international areas of food, health, sanitation, culture, etc. Standardize and clean up various old and new duplicated tax incentives, and focus tax incentives on essential products and services, finance, and other areas of necessity. At the same time, adjust the revenue structure of central and local taxes in order to seek a more complete and concise tax administration system.

Currently, China only applies a zero-tax policy to export some transportation and services and adopts a duty-free approach for most other service elements. This tends to result in double taxation at home and abroad and restricts the development of international trade. For export goods, a service tax rebate is an essential element in future VAT reform. Improving the tax rebate mechanism can also properly avoid the tax distortion arising from international trade in the world. Therefore, the government also

needs to improve the tax rebate mechanism for export trade to make VAT more international in the future.

In response to the booming global digital economy and e-commerce, China can thoroughly learn from the EU's governance experience in this area, actively explore practical tax collection and management methods, and deepen data management. The first step is to accelerate establishing a tax-related information collection platform that integrates information collection, provision, transmission, analysis, and application, improves the tax-related information protection system, and promotes information sharing and interoperability. The second step is to vigorously accelerate the research on the application of blockchain technology in the field of taxation; meanwhile, make good use of invoice data, such as a more standardized electronic invoicing process and a more simplified reimbursement process, so as to make tax information and governance more refined and effective.

A modern democratic state under the rule of law requires a clear, stable, and predictable relationship between the rights and obligations of the state and taxpayers. The existing provisional VAT regulations in China lack a certain degree of authority and normativity and do not meet the overall requirement of creating an efficient, transparent, democratic, and rule-of-law economic environment. There are some lags in the rule of law environment for taxation. In the future, the government should also speed up the legislative work on VAT, elevate the "regulations" to law, and fix the taxation scope, tax base, tax rate, reduction and exemption policies, and other taxation elements in the form of law, so as to improve the predictability of the taxation system and maintain the seriousness and stability of the law. This may also be the focus of future work.

6. Conclusion

After the previous analysis, we can also generally answer the question raised at the beginning of the essay.

According to Lockwood, B & Keen M, "the benefits of VAT tend to be greater in higher income and more open economies." In the case of the Chinese market alone, the continued rapid growth of the Chinese economy and the expansion of foreign trade has created a favorable condition for the implementation of VAT. In the EU, as a developed and open economy, the benefits of VAT are obvious. This is one of the reasons why EU countries are committed to a more open and unified common market and have generally started to adopt VAT at a relatively early stage.

For most developing countries, VAT has been introduced to improve the domestic business environment and increase tax revenues as trade liberalization has led to a decline in tariffs and the elimination of double taxation on domestic goods and services. This is because it is relatively easy to levy VAT on imported goods and, in some cases, can improve the efficiency of the overall tax system. However, some countries are also prone to the problem of constantly increasing tax rates. It may be that some countries' own economic conditions are not suitable for replicating the original VAT and its widespread application. To improve the operation of VAT and maximize its functions, it is still necessary to make appropriate reforms and corrections in a timely manner according to the country's situation.

France has completed the reform of value-added tax industry-wide coverage as early as decades ago. Therefore, value-added tax completely replaces sales tax and expands and clarifies its scope of application. However, with the continuous change of modern economic carrier, the rise of emerging industries has affected a large part of traditional industries. The adjustment and transformation of the scope of application of value-

added tax are necessary to deal with the various effects of the growing digital economy.

In conclusion, at a time when cross-border logistics and international trade have become the norm of various industries, production and service elements are rapidly flowing. On the one hand, the widespread application of new technologies inevitably leads to changes in production, structure, and lifestyle; on the other hand, the allocation and optimization of global resources and the transformation of free trade to multi-faceted and diversified, the tax systems of all countries are facing changes and adjustments. At the same time, in the face of the persistent impact of the new epidemic, governments also need to strengthen the structure of tax optimization so that they can better respond to such unexpected situations.

In order to build a more modern and internationalized tax system, it is necessary for countries to strengthen tax coordination and cooperation, govern together, and work together to create a relatively fair international tax environment.

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