

# Research on the Existing Problems and Countermeasures of Tobacco Consumption Tax Reform

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## Abstract

**The tobacco industry has been the focus of national taxation and reform. This is because tobacco is a special commodity, which not only has high production costs, but also smokes harmful public health and the environment, and has an impact on the national economy. As a result, the consumption tax reform has entered a very important step, that is, a step of legislation. This paper examines the current situation of tobacco consumption tax reform in China, finds problems from it, and then puts forward targeted countermeasures to optimize tobacco consumption tax reform from the perspective of problems.**

## Keywords

**Tobacco excise tax; Problems; Countermeasures research.**

## 1. Introduction

Consumption tax is the third largest tax in China and a very important part of government revenue. Looking at the domestic literature, there are many articles on tobacco excise tax reform. Since the implementation of the "VAT to VAT" in 2016, fiscal revenue has declined, fiscal revenue has faced great pressure, while fiscal expenditure has increased faster, which quickly led to the government's inability to make ends meet, resulting in a serious government fiscal deficit. On the one hand, there is a serious imbalance between central and local fiscal revenues, local revenues have plummeted, and the central government has no excess fiscal revenue, so in this case, on the other hand, as the conditions are getting better and better, all kinds of infrastructure equipment are also better. Local finances are facing multiple pressures, and it is also important to note that they are moving towards high-end goods, and the original tax targets are not conducive to the development of social taxation, so we need to improve them through new methods. As an important member of it, tobacco excise tax has also embarked on the road of reform. China's consumption tax reform has gone through several important processes, since 1994, China has implemented five major tobacco reforms, any change will have a significant impact on the revenue and profits of China's tobacco industry. In January 1994, China received 60 per cent of the tobacco products tax and began to collect VAT on tobacco products under a cost-effective control system. In July 1998, the tobacco product tax was revised for the second time, this time revising the inappropriate unified tax system according to the actual situation of the year, and introducing three tax rates. On July 1, 1998, the second reform of tobacco excise tax, this time focused on adjusting the unreasonable structure of the single tax rate according to the actual situation of the year, and implementing a three-level tax rate. In order to control tobacco consumption and increase taxes, the state has made a new round of policy adjustments to the 2009 tobacco consumption tax. In 2015, in order to increase the "tobacco tax control", China took measures to increase the wholesale tax rate of large-scale tax promotion, from 5% to 11%, and on this basis, a batch tax was added in this link. The wholesale price is 6% higher than before, and the recommended retail price is determined based on a gross retail margin of at least 10%. For the first time, the reform realized the link

between tobacco industry prices and taxes, and had a more positive impact on China's tobacco control effect. From 1994 to 2015, China carried out five tax reforms on tobacco consumption, linking tax collection from the initial production to the current double production and wholesale trade, the tax rate continued to rise, and the proportion of roll tax in the total cigarette consumption tax was also increasing. The increasing burden of cigarette excise taxes has made the effect of "tobacco tax control" even stronger.

## 2. The current situation of tobacco excise tax reform

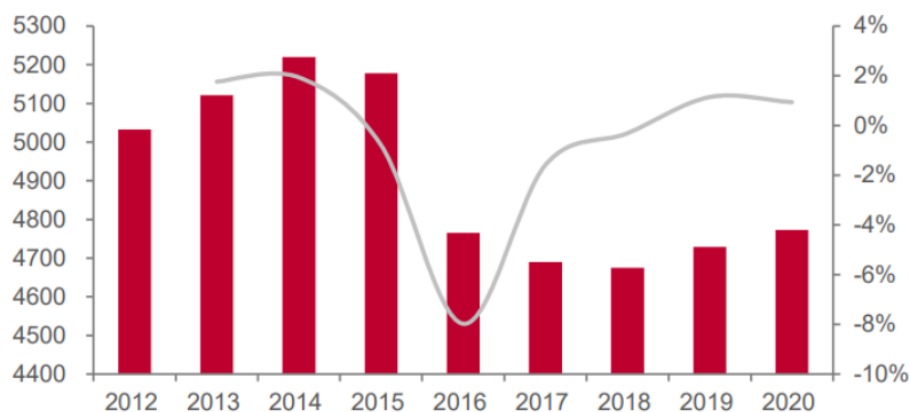
### 2.1. The current method of calculating tobacco excise tax

Now according to the current tobacco excise tax, it is necessary to collect taxes in two links. Among them, the wholesale link is taxed at 11%. The production process is relatively complicated. It should be discussed on a case-by-case basis. But no matter which link, whether complex or not, in fact, the calculation formula is basically the same, except for some specific numerical changes, there is no need to consider. Specifically, the formula can be expressed as follows: taxable amount = number of sales  $\times$  fixed tax rate + sales  $\times$  proportional tax rate.

Simply expressed as: in the production process, there are Class A and Class B cigarettes, which are taxed separately, and the ad valorem tax of 11% + ad valorem tax of 0.005 yuan / piece in the wholesale link

### 2.2. Cigarette production output

Cigarette production (10,000 boxes)

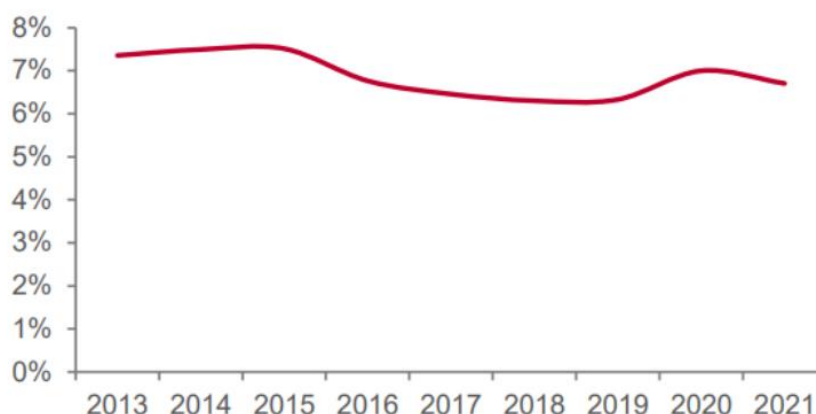


**Figure 1:** Cigarette production and growth rate

Source: National Bureau of Statistics, Zhongtai Securities Research Institute

As we can see from the chart above, cigarette production showed a significant decline from 2015 to 2016. This is closely related to a policy introduced by China that year. That is, at that time, tobacco control was proposed, and relevant policies were introduced. In the long run, cigarette production is expected to stabilize within 50 million boxes under the Chinese government.

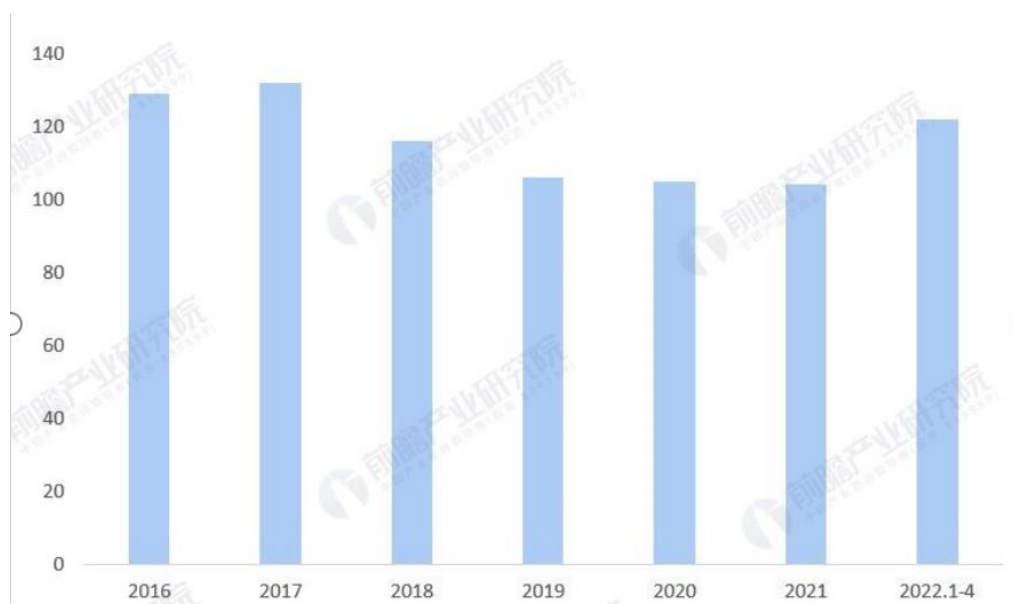
### 2.3. Tobacco excise tax revenues



**Figure 2:** Tobacco excise tax as a proportion of tax revenue from 2013 to 2021

From the above figure, we can see that the consumption tax revenue of tobacco is still relatively large, the proportion is also very high, and the annual proportion is still very stable. This shows that the contribution of tobacco to national tax revenue is very high. It is also a stable source of tax revenue and fiscal revenue for the country. From this, we can also show that there is some truth in reforming the tobacco excise tax.

#### 2.4. Changes in the number of tobacco enterprises



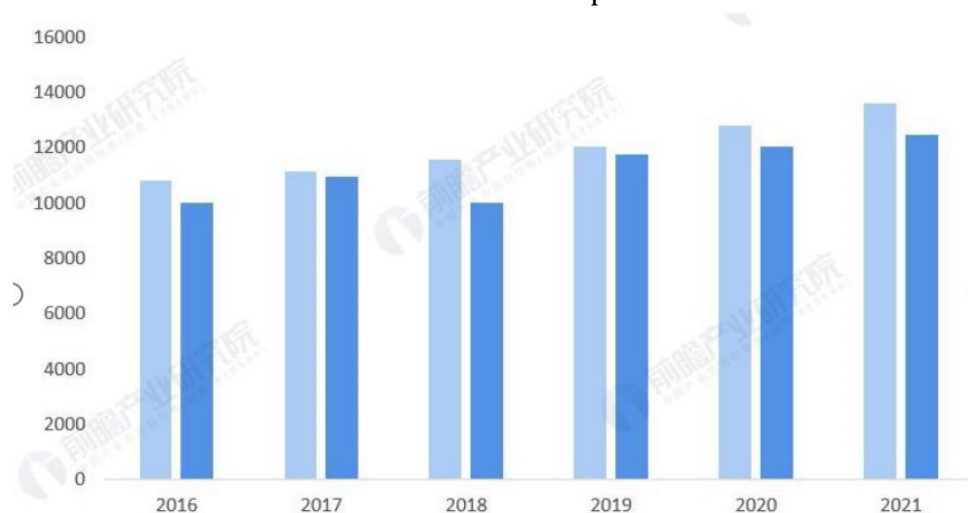
**Figure: 3** Changes in the number of tobacco product enterprises in China from 2016 to 2022 (unit: households)

Source: National Bureau of Statistics, Foresight Industry Research Institute

Since the tobacco consumption tax reform, we can see from the above figure that the number of tobacco enterprises has shown a fluctuating downward trend, which is undoubtedly good news, indicating that the tax reform has a significant impact on the tobacco industry, which is conducive to the implementation of China's tobacco control policy. It is conducive to cutting off China's smoking population from the supply side, which has reached the original intention of China's tobacco excise tax reform.

## 2.5. Industrial and commercial profits and taxes in the tobacco industry and the total amount of finance paid

Since May 10, 2015, China has significantly increased the cigarette consumption tax, the ad valorem tax rate for wholesale links has been increased from 5% to 11%, and an ad valorem tax of 0.005 yuan per unit has been levied. While raising taxes, the State Tobacco Monopoly Administration will adjust and appropriately increase the wholesale price of cigarettes and the recommended retail price. The effectiveness of tax and price instruments in controlling tobacco consumption has been demonstrated by practice and research in many countries around the world. In 2016, the total amount of industrial and commercial profits and taxes and the total amount of finance paid in China's tobacco industry decreased significantly compared with 2015. However, since 2017, the tobacco industry has gradually returned to the pre-consumption tax level, and has shown an increasing trend of increasing volatility year by year. According to data from the National Bureau of Statistics, the tobacco industry achieved a total industrial and commercial tax profit of 1,358.1 billion yuan in 2021, a year-on-year increase of 6.08%; The total fiscal volume was 1,244.2 billion yuan, an increase of 3.36%, achieving a record high in total tax profits and total fiscal revenue, making positive contributions to the increase of national and local fiscal revenue and economic development.



**Figure 4:** Changes in industrial and commercial profits and taxes and total financial contributions in the tobacco industry (unit: 100 million yuan, %)

Source: National Bureau of Statistics, Foresight Industry Research Institute

## 3. The problem of tobacco excise tax

### 3.1. The implementation of in-price taxes is not conducive to guiding consumers' consumption

To some extent, the tax inside and outside the price have their own advantages, but from a philosophical point of view, we need to treat each tax specifically and make the choice that suits him accordingly.

First of all, tobacco excise tax is included in the price, consumers do not know how much tax they pay when they buy cigarettes, so for some people who do not understand the tax, they will only think that the price of cigarettes is high and cannot play a good role in smoking smoking. In addition, the source of taxation is not clear, and the consumption tax within the tobacco price will be easily combined with other taxes, resulting in double taxation. This is also not conducive to the implementation of tax collection by the tax authorities. Therefore, it is necessary to reform the excise tax within the price of tobacco.

### **3.2. The cigarette excise tax rate is not uniform**

This is reflected in the fact that cigarettes are not taxed once to complete their tax obligations, but they need to be taxed twice. Moreover, when the first tax is levied in the production process, different tax rates will be given according to the specifications of the cigarette, which has major defects to some extent. Specifically, first, production enterprises will have different tax tasks when paying taxes. That is, there will be a difference in the tax burden, if the enterprise produces good cigarettes, then its tax rate is high, and the corresponding tax will be more, on the contrary, for some enterprises that produce poor cigarettes, their tax rate will be low, and their tax burden will be relatively light. This is not conducive to the structural adjustment of the production of cigarettes and related products, and is also not conducive to the rational utilization and allocation of resources. Second, in order to reduce the tax burden, tobacco manufacturers will falsely declare the price of products, that is, the factory price, and reduce the tax payment standard, so that the national tax revenue will be reduced, infringing on the country's fiscal revenue.

### **3.3. The comprehensive tax rate of tobacco is low**

The World Health Organization usually uses the example of a country's best-selling cigarette brand, and this can be measured by calculating the ratio of total tax (excluding income tax) to the original price in a pack of cigarettes (i.e. the comprehensive tobacco tax rate). Taking China's best-selling cigarette brand as an example, the comprehensive tax rate is still low compared with the international one. For example, in 2021, China's comprehensive tobacco tax rate was 45.8%. It ranks 101st among the 190 countries and territories recorded by the World Health Organization, which is in the middle and lower level, 45.3 percentage points lower than Chile (89.1%), which has the highest comprehensive tax rate, and is still far from the WHO statement of 75%.

### **3.4. The division of income is not reasonable**

Under the existing circumstances in China, tobacco consumption tax belongs to the state, but tobacco consumption tax can be reasonably deducted when calculating income tax, although this is said to increase the revenue of the central government, but the local government will significantly reduce the income from other taxes, so that the central and local tax revenue will be further expanded. Such words are prone to contradictions. At the same time, because local governments can get revenue from tobacco VAT, they will protect local tobacco companies, which is not conducive to China's control of tobacco enterprises. The implementation of tobacco control policies in our country will have a hindrance effect.

## **4. Research on countermeasures for tobacco excise tax reform**

### **4.1. Change the calculation of taxes within the price to the calculation of taxes outside the price, and establish a correct concept of tobacco consumption**

The tobacco excise tax we are implementing now adopts the method of intra-price taxation, and the tax is included in the market price of cigarettes, and when consumers buy cigarettes, the tobacco excise tax has been passed on to the buyer through the tax burden. Consumers do not know how much tax they pay when they buy cigarettes, so for some people who do not understand taxes, they will only think that the price of cigarettes is high and cannot play a good role in smoking smoking.

To change the tobacco excise tax into a tax calculation method other than the price, we can learn from the method implemented by other taxes, and separate the price and tax when invoicing, not combined. It is clearly listed on the invoice, so that consumers can clearly see how much tax they have borne when purchasing, so as to guide them to spend reasonably. However, the

premise of this can be achieved is that it is inseparable from the help of the government, and the government must play a full role in guiding consumers to pay attention to the role of invoices and strengthen the management of invoices. At the same time, it should be made clear that the high price of cigarettes does not indicate that the quality of cigarettes is good, but may simply contain more taxes.

#### **4.2. Rationally divide tobacco excise tax revenues**

At present, the tobacco excise tax revenue still belongs to the central tax revenue. However, because the tobacco industry has its own particularities, in the eyes of local governments, the existence of the tobacco industry will drive local economic development and promote local employment, so the tobacco industry will be protected by the local government and is in a monopoly position. It is not conducive to the merger and reorganization of enterprises.

Change the tobacco excise tax to a tax that can be shared between the central and local governments. Specifically, the revenue from the first line of taxation can be collected by the central government first, so that tobacco excise taxes will be transferred from the major cigarette-producing provinces to other regions, promoting cross-regional mobility; Then the cigarette excise tax collected in the second link is collected by local governments at all levels, so that the lost tax revenue of provinces with more tobacco excise tax revenue can be made up in this way. If, in the future, when conditions permit, when all measures are complete, we can carry out further reform and choose to tax in the third link, that is, the sales link, which can increase China's comprehensive tax rate and reach the level of international standards, and at the same time, it can alleviate the protection of local governments for tobacco monopoly, reduce the difficulty of enterprise mergers and reorganizations, and also help improve the central control and macro-control ability of the tobacco system.

#### **4.3. Improve the method of "ad valorem as the mainstay, supplemented by the quantity"**

The change of tax calculation method can start from the following two aspects: First, the volume tax burden of cigarettes will be further increased. Because the quantity levy is not related to the sales price of cigarettes, but to the quantity purchased by consumers. After the increase in the quantitative tax, it has great advantages, can increase fiscal revenue, and at the same time can stabilize tobacco prices and avoid large fluctuations in market prices. The second is to further increase the ad valorem tax rate. Raising the ad valorem tax rate and implementing the reform of the extra-price tax can further reduce tobacco consumption and create a less smoking environment. It is conducive to the healthy development of China's economy.

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