

# *A new big data era for tax administration – what to expect from China’s Golden Tax III Project?*

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## *In brief*

In 2016, the implementation of the Third Phase of the Golden Tax Project (Golden Tax III) in Beijing, Shanghai, Shenzhen and Guangdong, etc. has been completed and it is entering into an accelerated stage to cover the other locations in China. Under the plan of the State Administration of Taxation (SAT), the Golden Tax III will be rolled out nationwide within 2016.

The Golden Tax III aims to achieve consistent tax administration backed by information technology and processing of tax data in a highly efficient manner nationwide. As such, it will not only transform the tax authority’s operating system, but will consequently alter taxpayer’s tax compliance procedures as well. Upon the implementation, an improved system and optimised procedure will help the tax authorities to tighten their administration of taxpayers. The Golden Tax III can automatically detect tax risks which were being ignored before and will result in penalty and impact the taxpayer’s credit on tax collection.

It is recommended that taxpayers should start by sorting out weaknesses in their internal control system, improving invoice administration and enhancing tax compliance in order to be well prepared for the upcoming new challenges brought by the Golden Tax III.

## *In detail*

### *Background*

Launched in 1994, the Golden Tax Project (the “Project”) is a set of systematic program for tax information administration in China. After years of experience gained in constructing the Project’s First Phase and Second Phase, the SAT officially launched the Golden Tax III in September 2008. It has now entered into the accelerated stage after several pilot runs in Guangdong, Shandong and Chongqing, etc. during the past years and its nationwide implementation is expected to be completed in 2016.

Different from the First Phase and Second Phase of the Project, the Golden Tax III not only incorporates the existing VAT invoice system, but also integrates with the “China Taxation Administration Information System” (CTAIS). It covers all tax authorities, all tax categories and the major tax-related work and realises the paperless implementation of various taxation procedures. At the same time, the Golden Tax III will unify the national tax administration standard for data, compliance and penalty, establish an effective system on tax information exchange, and achieve centralised processing and analysis of multiple-sourced data at the state and provincial levels.

On one hand, the Golden Tax III provides multiple benefits for taxpayers, such as online application of record-filing for

various tax incentives, information sharing between state tax bureaus and local tax bureaus so as to avoid duplicate report and submission, etc. One the other hand, it will help tax authorities efficiently identify and detect taxpayer’s non-compliance activities by virtue of its strong capacity in data analysis and tax supervision automation. We hereby summarise the changes and impacts upon the implementation of the Golden Tax III as follows:

### *Optimising tax risk identification and case selection for tax investigation*

Under the *Plan on Deepening the Reform of Tax Collection and Administration System of State Tax Bureaus and Local Tax Bureaus* released in 2015, the SAT and provincial tax

authorities are required, from 2016, to 1) lead and conduct tax risk analysis by industries and on large enterprises, 2) verify tax filing by utilising tax information obtained from third parties, 3) alert taxpayers of their tax risk, schedule meetings for tax assessment and conduct tax audit respectively according to the risk levels identified in order to effectively prevent, investigate and penalise tax evasions by taxpayers.

As a system support to the aforementioned goal, the Golden Tax III will gradually become the centralised processor of tax data at state and provincial levels. Moreover, it will reserve an interface for connecting with third party information so that the tax data can be automatically connected and verified on a real-time basis with information obtained from the system used by Customs, banks, Industry and Commerce Administrations, etc. Up till now, the case selection system of the tax investigation bureau has already been successfully interconnected with the Golden Tax III, which creates a more efficient case selection approach through the automatic selection of high-risk enterprises based on the data provided by the Golden Tax III. In addition, the Golden Tax III also helps tax authorities extract common data indexes for analysis so as to timely identify the tax risk areas of certain industries. It can be anticipated that the tax authority's capacity and efficiency in detecting tax risks will be substantially improved after the complete implementation of the Golden Tax III.

### ***E-administration of VAT invoices***

The VAT invoice system is a crucial component of the Project. With the upgrade and development of the Project, the Chinese tax authorities have implemented the upgraded version of the VAT invoice system since 2015.

For output VAT, all special and ordinary VAT invoices have to be issued online through the upgraded VAT system unless otherwise stipulated. Meanwhile, the information of VAT invoices issued have to be uploaded immediately to the tax authority's database as electronic record, which can be used later as reference during tax filing, invoice verification, tax source administration as well as data analysis

and application. It is also important to note that from 1 May 2016, taxpayers are required to select from the *Catalogue and Code of Taxable Goods and Services*<sup>1</sup> (the "Catalogue") while issuing VAT invoice. This Catalogue covers more than four thousands of goods and services. Consistent implementation of the Catalogue in China will help tax authorities identify, calculate, analyse, select and compare the VAT rate of different goods, which provides a solid ground to facilitate their subsequent tax risk administration. Besides, e-invoice issuance is gradually improved with the further implementation of the upgraded VAT invoice system in China, which helps taxpayers reduce relevant compliance costs and improve their administrative efficiency.

For input VAT, the application of upgraded VAT invoice system will also change taxpayers' process flow in VAT invoice issuance. Currently, the VAT invoice verification requirement is waived for taxpayers with grade A or grade B rating in tax collection credit. Instead, these taxpayers can directly log onto the relevant website enquiring and selecting the VAT invoice information for the purpose of claiming input VAT credit.

With the digitalisation of output and input VAT administration, taxpayers can reduce cost in their invoice administration while tax authorities can have a better understanding of taxpayers' business operation, tax payment and industry average through vertical and horizontal analysis. After the invoice information is comprehensively reported to the tax authorities real-time, taxpayers would be facing a more effective and stringent tax administration.

### ***Stringent implementation of procedural regulations***

The Golden Tax III incorporates the prevailing tax laws and regulations into the system. The procedural provisions, particularly those timeline requirements which were not previously administered stringently will be closely monitored under the new administrative system.

Taking payment for cross-border charges as an example, according to relevant regulations<sup>2</sup>, both the Non-Tax Resident Enterprise (Non-TRE) providing services and the party receiving services in China have, within 30 days of concluding the contract, to perform record-filing registration on the relevant tax

matters. Moreover, withholding agents paying interests, rental income, royalty, and capital gains, etc. to Non-TREs also have to perform record-filing registration within 30 days of signing the contract. Before the implementation of Golden Tax III, some taxpayers were of the view that there should not be any tax risks as long as there is no underpayment of taxes and did not perform record-filing registration in a timely manner and there was also a lack of systematic administration on the part of the tax authorities to monitor and supervise taxpayers in this regard. The Golden Tax III Project has now set out these prescribed timelines in the system. When payments are made for cross-border charges, the system will automatically detect those contracts which have not undergone record-filing registration and generate notices to levy penalty accordingly. Under the *Tax Collection and Administration Law*, the penalty is generally capped at RMB 2,000. The actual amount of penalty may vary subject to different locations. In brief, the 30-day timeline for record-filing registration has now become a must-supervise item rather than an optional-supervise item by the tax authority. Taxpayers should be serious with filling in information, such as "date of signing the contract", "date of payment", etc. to avoid triggering the "treatment for tax violation behaviour" process because of any unintended mistake.

In addition to the contract record-filing registration, there are many other timeline requirements in the prevailing tax laws and regulations, such as the registration relating to alterations of tax matters, report on changes in qualifying criteria to enjoy tax incentives, report on change of deposit account, record-filing of the financial and accounting system, etc. Taxpayers should be well prepared for these timelines and ensure their compliance. It is also noteworthy that non-compliance in such tax matters may not only result in penalties, but may also result in demerit points in the system, which would consequently affect the enterprise's tax credit rating<sup>3</sup>, qualification in enjoying incentives for credit / loans and foreign exchange activities<sup>4</sup> and even impact their classification in export tax refund and exemption<sup>5</sup>.

### ***The takeaway***

The Golden Tax III is expected to be implemented nationwide by the end of 2016. Based on the past experience

gained, it is now being upgraded and improved constantly by addressing the problems identified. Taxpayers should upgrade their tax system in a timely manner and positively communicate with the tax authority. Further, we would suggest enterprises, in enjoying the convenience brought by the Golden Tax III, to pay attention to the following areas so as to comply with the higher standards brought about by the Golden Tax III:

#### **Sorting out weaknesses in the internal control system**

Enterprises should prevent tax risks at the source, sort out weaknesses in the internal control system and make improvement according to the prevailing tax laws and regulations. Meanwhile, they should ensure smooth communication between various in-house departments to ensure that consistent information is provided to different external governmental departments. Besides, they should also provide more training to their finance and tax personnel to ensure they are skilful in operating the Golden Tax III (enterprise terminal) so as to avoid any tax risks caused by human error in operating the new system.

#### **Improving invoice administration**

With the enhancement of VAT invoice supervision by the tax authorities, enterprises should improve their invoice administration mechanism by standardising the process at different stages of VAT invoice administration – application, storage, issuance and claiming of credit, etc. At the purchasing stage, enterprises should verify in details the invoice information when the VAT invoice is obtained to ensure the input VAT could be fully credited. At the same time, they should formulate effective internal control procedures, study their supplier's business information and strictly examine their qualifications in order to reduce the tax risk. At the sales stage, they should ensure that the information, category and codes of goods are correctly inputted on the invoices

issued and VAT invoices issued in relation to particular activities such as sales return or discount is fully complied with the tax regulations.

#### **Paying attention to complying with in procedural requirements**

Enterprises should strictly comply with the procedural requirements such as registration, record-filing, tax filing and report of alternation, etc. There are already recent cases in Shenzhen, Shanghai and Beijing where enterprises are being fined for not performing record-filing of service contracts with non-TRE within the prescribed timeline. Enterprises should pay close attention to the date of signing the contract, date of record-filing and date of payment. If there is a supplementary contract, enterprise should also timely report to the tax authority for updating the date of signing the supplementary contract to ensure compliance.

#### **Transitional treatment**

Currently, the Golden Tax III does not have a uniform set of nationwide operating manual; therefore the local-level tax authorities are exploring how to operate the system. At the same time, some problems are identified in the system in linking up some new circulars with old circulars during its operation. For instance, the tax treaty benefit for dividend income approved according to Guoshuifa [2009] No.124 shall be still valid for 3 years until its expiration after the effective date of the new circular and there is no requirement to re-submit documents relating the claiming of such treaty benefit<sup>6</sup>; however, after the Golden Tax III went on line, some non-resident taxpayers are still being requested to re-submit the documents for treaty benefit purpose, which would create certain compliance burden on the taxpayers. When faced with such problems, taxpayers should proactively discuss with their tax authority to understand whether such re-submission of documents is merely an automatic request generated by the new system or a new direction of the tax authority in risk administration. At the same time, taxpayers should

ensure that the new documents submitted should be consistent with those already submitted to the tax authority in order to avoid unnecessary challenges by the tax authority.

#### **Endnote**

1. For details of the Category and Code of Taxable Goods and Services, please refer to the SAT Public Notice [2016] No.23.
2. For the regulations on record-filing registration of Non-TREs and withholding agents, please refer to the Provisional Measures of Tax Administration for Non-tax Resident Engaged in Contracting Projects and Provisions of Services (SAT Order [2009] No.19) and the Provisional Measures on the Administration of Withholding CIT at Source for Non-TREs (Guoshuifa [2009] No.3).
3. For details, please refer to the Administrative Measures on Credit on Tax Payments (Trial) (SAT Public Notice [2014] No.40) and The Index System and Evaluation Method for the Credit Rating of Taxpayers (Trial) (SAT Public Notice [2014] No.48).
4. For details, please refer to the Memorandum of Collaboration on Implementing Joint Incentive Measures on Taxpayers with A-Level Rating under the Tax Payment Credit Rating System (Fagaicaijin [2016] No.1467).
5. For details, please refer to the Measures for the Tax Administration Based on Classification of Enterprises Eligible for Export Tax Refund (Exemption) (SAT Public Notice [2015] No.2).
6. For details, please refer to the Administrative Measures for Treatments on Income of Non-Residents under Double Tax Agreements (Trial) (Guoshuifa [2009] No.124) and the Administrative Measures on Non-resident Taxpayers Claiming Tax Treaty Benefits (SAT Public Notice [2015] No.60).

### **Let's talk**

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\* These results are based on an independent survey of 130 primary buyers of tax services in China, conducted by research agency Jigsaw Research (Q1-Q4 2015).

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