Transforming the in-house tax function in China through technology

A practical guide to 2020

kpmg.com/cn

Part B

Now let's begin our journey

Starting on a journey to embrace technology, even on an incremental basis, is necessary to keep up, and also maintain or even enhance the value of the tax function to the organisation it serves.

So by now we have hopefully helped you to understand some of the problems within your organisation which tax technology may help you to fix; we have shared with you a framework through which to consider how most tax technology solutions fit; we've discussed the need to consider incremental change, and acknowledged the need for realism (and patience).

Now we move into the really important aspects of tax technology, and given our emphasis on keeping this simple, we've broken down the issues into their most fundamental building blocks. Specifically:

1. **Why** would you do it? In other words, why do you wish to transform your in-house tax function to be ready to embrace technological change?

2. **What** should you do? That is, what types of tax technology do you need in your organisation?

3. **Who** should help you to do it? What people will you need?

4. **How** should you do it? That is, how should you prioritise between different types of technology solutions, and how should you build a business case to do this?

5. **Does** it work in China? These are specific issues to troubleshoot before deploying any tax technology solution to serve your business needs in China.

In the following sections we explore each of these questions in turn.

Section 1

Why do it?

Even if you know you wish to transform your in-house tax function to be ready to embrace technological change, the question is why do it? Is it because of the need to remove inefficiencies? Is it because of a desire to optimise tax outcomes? Is it because your organisation is susceptible to tax risks that you cannot get control of? The answer is ordinarily all of the above, but different facets of your tax function may vary in terms of the priorities which are to be addressed.

In the previous section we let you in on a little secret that most tax technology solutions can be placed into one of 4 different buckets or categories. Now let's give the reasons why most organisations choose to deploy them.

Types of tax technology solutions	The analogy with building a house	Why do it? (Most common reasons)
Compliance related solutions	– Like the walls and roof of the house, core to your organisational needs	– To remove inefficiencies in existing manual processes – To ensure greater accuracy and/or transparency of returns
Insight related solutions	– Like the interior design of the house, with the most potential to make a difference and enhance the tax function	– To optimise tax outcomes – To obtain better insights to help manage tax risks – To create efficiencies
Process management solutions	– Similar to the concrete which holds the bricks of the house together, they held to bind and enable the tax function to operate efficiently	– For efficiency and accountability for decision-making – To ensure clear lines of responsibility – To share information within the organisation
Accessories, components or infrastructure	– Like the foundations of a house – typically unseen, but can cause the whole technology structure to falter without it	– To enable or facilitate compliance, insight and process management solutions – Investment is not seen as a benefit of itself, but rather a means to an end

Even though a business may choose to invest in tax technology because of the benefits to that organisation, what typically causes an acceleration to any investment decision is the news that the tax authorities are doing likewise.

Obviously there may be specific reasons why your organisation may wish to invest in certain technology solutions that differ from the reasons set out in the above table, so this is just a general guide.

The additional X factor – supercharging your technology investment

Even when an organisation believes they know "why" they wish to invest in technology, there is an additional X factor which may turbocharge any such decision resulting in investment decisions being prioritised above all else. That additional X factor is the tax authorities in China.

What do we mean by this?

Put simply, the reason organisations often choose to accelerate their investment in tax technology is because of the threat or concern that the tax authorities may have developed their own technology which could shine a light on an organisation's deepest darkest secrets – to highlight its risks, or any breakdown in controls which expose the organisation to tax liabilities.

In our experience, even though a business may choose to invest in tax technology because of the benefits to that organisation, what typically causes an acceleration to any investment decision is the news that the tax authorities are doing likewise.

In this regard, it is useful to spend just a few moments exploring what the tax authorities are doing in China in the field of technology solutions.

In an excellent article published in International Tax Review's China Looking Ahead series in 2017 and entitled "Adding Wings to a Tiger – Data in Tax Enforcement in China", several KPMG China tax partners[8] examined the latest developments in the capturing or pooling of data to support the tax authorities work, in their data analysis enhancement capabilities, and in the technology they are deploying. Set out below we have captured just a snapshot of these developments.

For an international audience reading this publication, it is pertinent to note that the challenge for tax authorities in most countries is in getting the data from businesses in the first place, especially at a transactional level. However, that challenge has already been overcome in China, with the tax authorities having access to transactional level data through its **Golden Tax System**. Now the challenge in China is more about the tax authorities deploying and upskilling their people to better analyse the data.

Enhanced data analysis and risk profiling

China's tax authorities are taking a number of steps to improve their data analysis and risk profiling capabilities, through initiatives such as the following:

- The State Administration of Taxation (SAT) launched the "Thousand Enterprises Initiative" (TEI) in July 2015. This program covers approximately 1,000 representative large group enterprises from different industries. Under this initiative the SAT collects data from the TEI-covered group enterprises and their member entities (through local tax authorities) for tax risk analysis. Based on the analysis, the SAT has built risk analysis models with risk indicators for different industries.
- Circular Shuizongfa [2014] No. 105 SAT *Opinion On Strengthening Tax Risk Management*, sets out key tax risk management tasks for tax authorities. These include tax enforcement goal setting, information collection, risk identification, risk ranking, risk resolution, as well as risk management process monitoring, assessment and feedback.
- The SAT on 18 April 2017 issued SAT Announcement [2017] No. 10 (Announcement No. 10), which provides taxpayers with the option of being assisted (through an automated solution) in identifying and correcting tax calculation errors, in advance of formally submitting their CIT annual filing returns. As Announcement No. 10 makes clear, this automated solution draws attention to potential issues in tax calculations, non-correlation between tax data and financial data, and other analytical results which might prompt a taxpayer to reconsider their original inputs. The information on which the analysis is based is drawn from a variety of sources, including taxpayer tax registration, historic tax filings, financial and accounting data, record filings, third party and industry data.

In China there is a turbocharged factor in place, namely the prospect of the tax authorities being able to shine a light in the deepest darkest crevices of your organisation's data and tax reporting.

8 'Adding Wings to a Tiger – Data in Tax Enforcement in China', Tracy Zhang, Wei Fang, Anthony Chau and Lilly Li, International Tax Review, 5 December 2017, https://home.kpmg.com/cn/en/home/insights/2017/12/china-looking-ahead-edition-7.html

Enhanced data collection and/ or pooling

The following summarises the enhanced measures through which the tax authorities are either getting more data from taxpayers, or achieving higher quality data:

- SAT Announcement [2016] No. 67 on *The Filing of Financial Statements Upon Submission of Tax Returns for "1,000 Group Enterprises" And Their Member Entities*, was published on 26 October 2016 and took effect from 1 December 2016. This requires TEI enterprises to file financial statement information with the tax authorities, both at the time of filing periodic tax returns during the year (i.e. quarterly), and with the filing of the annual tax return (i.e. filed each May following tax assessment year-end). Financial statements (to be supplied in electronic form) include balance sheets, income statements, statements of equity changes, and their disclosure notes, for every legal entity in a corporate group in China.
- SAT Announcement [2017] No. 7 on *The Management Measures on The "1,000 Group Enterprises" Catalogues*, took effect from 1 May 2017. This requires TEI enterprises to report certain entity information to the tax authorities on an annual basis (i.e. each May), which will be maintained on a data platform. This includes details of the taxpayer's in-charge tax bureaus, operating locations, industries of activity, parent company, tax payments in prior years, revenue in prior years, and listed status.
- The Golden Tax System Phase III provides for the centralized collection of national tax data from all taxpayers registered with the thousands of individual tax bureaus at all levels of government across the country. This covers both local tax bureaus (LTBs - responsible for local government taxes) as well as state tax bureaus (STBs – responsible for central government taxes). The Golden Tax System Phase III aggregates data from all taxpayer-authority interactions, including tax and incentive filings, tax payments, tax audits/enquiries, records of outbound payments from China, tax invoice issuance/certification, and information from reviews of taxpayer internal tax controls. This is taken together with webcrawler/public website searches on taxpayers, industry profiling information used to assess tax risks, information obtained from overseas tax authorities, and from other domestic agencies, such as the foreign exchange control regulator (SAFE – State Administration of Foreign Exchange) and the commerce ministry (MOFCOM – Ministry of Commerce). Tax officials in different tax bureaus across China can tap into this system, to see prior interactions that taxpayers may have had with tax and other governmental authorities.
- Under the forthcoming new Tax Collection and Administration (TCA) Law, Chinese financial intermediaries will be required to bulk report client account transactions (exceeding a certain minimum value) to the tax authorities together with the relevant clients' tax identification numbers (TINs) to facilitate data matching (e.g. cross-checking of IIT filings), and risk 'red flagging'.
- SAT Announcement [2017] No. 14 on Administrative Measures on Due Diligence Checks on Tax-related Information of Non-residents' Financial Accounts, was published on 9 May 2017, and took effect on 1 July 2017. This provides the detailed rules under which China is rolling out the The Organisation for Economic Co-operation and Development's (OECD) Common Reporting Standard (CRS) for the automatic exchange of tax information. Financial institutions with operations in China were required to register on the SAT CRS web platform by 31 December 2017, and then report to the SAT tax information on the accounts of non-residents held with their institutions (including tax ID, balance, receipt of different income types) by 31 May every year (starting May 2018).
- Since 2016 the Golden Tax System has provided a powerful platform for pooling tax data from all levels of tax bureau across China, covering both central government and local taxes. Its user interfaces facilitate both taxpayer and tax authority engagement and input, and drives standardization of certain key data inputs. The upgraded system also requires taxpayers to input "goods or service codes" so that the authorities obtain standardized data on what goods or services have been covered by the invoices. This facilitates the tax authorities to monitor closely invoice creation to detect fictitious invoices, ensuring the integrity of invoice information and the authenticity of filing data.

What results are the tax authorities achieving in China?

The proof in terms of the success of these measures by the tax authorities is starting to become evident. For example, as reported by China Tax News in their article of 7 December 2016, *"Tax Administration of Large Enterprise Marked Highlights in 2016",* data collection has now finished for 95 percent of the TEI-covered enterprises, resulting in six batches of TEI enterprises being followed up regarding identified tax risks, leading to an additional tax adjustment of RMB 20.19 billion.

Furthermore, Branch five of the Beijing State Tax Bureau has been assigned to support the SAT to work on the analysis of TEI information. 1,356 reports have been put together, covering 11 tax categories, 2,880 risk points, and involving additional tax adjustments of approximately RMB 66 billion.

What may hold back investment in tax technology?

The most common reasons in our experience for organisations to hold back their investment in tax technology fall into one of these four categories:

(1) apathy, (2) fear of the unknown, (3) poor data quality; or (4) future finance transformation. Let's take each of roadblocks in turn.

Apathy is the idea that because the organisation has always done things in a certain way, then why would there be a need to change it? It's the old saying – 'if it ain't broke, don't fix it'.

The problem with this paradigm is that the world is changing, business models are evolving, and tax authorities are enhancing their technology as we have already discussed. In short, technology is everywhere, and it is advancing at a very rapid pace. So to do nothing in a world of technological advancement is in fact to fall backwards rather than to lie stagnant. Those who do nothing risk being replaced, or perhaps more likely, for the status and value of their tax function in their organisation to reach a state of terminal decline. Therefore, starting on a journey to embrace technology, even on an incremental basis, is necessary to keep up, and also maintain or even enhance the value of the tax function to the organisation it serves.

The other phenomenon which we see all too commonly in China is '**fear of the unknown**'. It is the idea that by deploying tax technology tools such as data and analytics solutions, it will highlight errors which may result in a loss of face or status for those who have presided over those errors.

The problem with this type of fear is that while it may defer exposure or correction in the short-term, in the longer-term it's a strategy which will prove disastrous. Those same errors will continue to accumulate, and moreover, with an ever greater likelihood that they will be uncovered by the tax authorities rather than by the organisation itself. This is where the CFO and other "C" level executives need to take a greater role in overseeing the governance and strategy of the tax function, to ensure that they demand a high performance culture and a modern tax function. But it also requires an understanding and acceptance that technology tools enable the tax team to identify the proverbial 'needle in the haystack' which was simply not possible before.

So the culture and environment in which tax technology is deployed needs to recognise the value in shining a light on an organisation's previously unseen problems, to help to get them under control, to prevent their recurrence, and to align reward and recognition with the detection and prevention of risks rather than being associated with the identification of past liabilities. Moving to this type of culture produces long-lasting benefits.

Another common excuse often heard in China is that '**tax technology solutions will not be beneficial to our organisation because the quality of our data is** poor'. And so it shall remain if this mantra is accepted! Here is where the deployment of tax technology solutions may produce benefits in two stages – the first stage being the identification of data improvements which need to be made, and the second stage being the greater insights obtained from those data improvements.

And finally, an oft-cited reason for deferring investment in tax technology is that '**we are rolling out a new ERP system' in 'X years' time**'. While future changes in ERP systems may reasonably defer major tax technology investment decisions, typically this is put forward as an excuse for apathy. For example, if the organisation is really rolling out a new ERP system in the future, then where is the strategy for how tax technology will be deployed upon its arrival? And what is the tax function doing to ensure that the new ERP system delivers them the data they will need? The simple point here is that there is much which can and should be done in readiness for such a new ERP system – this should drive greater change, not lessen it.

So in short, the evidence is clearly there that organisations need to consider turbocharging their investment in technology if they perceive they may be exposed, either through errors, heightened tax risks, or even where there is a lack of transparency over their data, or controls over their tax processes. Put simply, the tax authorities in China now have an exponentially greater prospect of finding them, even if you don't. Furthermore, many of the reasons put forward for not deploying tax technology solutions merely represent excuses for apathy which potentially create greater problems later.

Returning to the question of "why" you would invest in tax technology – the answer is for all of the reasons set out in the table above. However, in China there is a turbocharged factor in place, namely the prospect of the tax authorities being able to shine a light in the deepest darkest crevices of your organisation's data and tax reporting. Would you prefer to be in control of finding it and fixing it, or would you prefer others to do it for you?

Contact us

Lewis Lu
Head of Tax
KPMG China
E: lewis.lu@kpmg.com
T: +86 (21) 2212 3421

Chris Ho
Tax Partner
KPMG China
E: chris.ho@kpmg.com
T: +86 (21) 2212 3406

Lachlan Wolfers
Head of Indirect Tax
Tax Technology Chair
KPMG China
E: lachlan.wolfers@kpmg.com
T: +852 2685 7791

Alexander Zegers
Director Tax Technology & Analytics
KPMG China
E: zegers.alexander@kpmg.com
T: +852 2143 8796

Lilly Li
Tax Partner
KPMG China
E: lilly.li@kpmg.com
T: +86 (20) 3813 8999

Michael Li
Tax Partner
KPMG China
E: michael.y.li@kpmg.com
T: +86 (21) 2212 3463

Tracy Zhang
Tax Partner
KPMG China
E: tracy.h.zhang@kpmg.com
T: +86 (10) 8508 7509

Stanley Ho
Tax Partner
KPMG China
E: stanley.ho@kpmg.com
T: +852 2826 7296

Mainland China

Beijing
8th Floor, KPMG Tower, Oriental Plaza
1 East Chang An Avenue
Beijing 100738, China
Tel : +86 (10) 8508 5000
Fax : +86 (10) 8518 5111

Chengdu
17th Floor, Office Tower 1, IFS
No. 1, Section 3 Hongxing Road
Chengdu, 610021, China
Tel : +86 (28) 8673 3888
Fax : +86 (28) 8673 3838

Chongqing
Unit 1507, 15th Floor, Metropolitan Tower
68 Zourong Road
Chongqing 400010, China
Tel : +86 (23) 6383 6318
Fax : +86 (23) 6383 6313

Foshan
8th Floor, One AIA Financial Center
1 East Denghu Road
Foshan 528200, China
Tel : +86 (757) 8163 0163
Fax : +86 (757) 8163 0168

Fuzhou
Unit 1203A, 12th Floor
Sino International Plaza,137 Wusi Road
Fuzhou 350003, China
Tel : +86 (591) 8833 1000
Fax : +86 (591) 8833 1188

Guangzhou
21st Floor, CTF Finance Centre
6 Zhujiang East Road, Zhujiang New Town
Guangzhou 510623, China
Tel : +86 (20) 3813 8000
Fax : +86 (20) 3813 7000

Hangzhou
12th Floor, Building A
Ping An Finance Centre, 280 Minxin Road
Hangzhou, 310016, China
Tel : +86 (571) 2803 8000
Fax : +86 (571) 2803 8111

Nanjing
46th Floor, Zhujiang No.1 Plaza
1 Zhujiang Road
Nanjing 210008, China
Tel : +86 (25) 8691 2888
Fax : +86 (25) 8691 2828

Qingdao
4th Floor, Inter Royal Building
15 Donghai West Road
Qingdao 266071, China
Tel : +86 (532) 8907 1688
Fax : +86 (532) 8907 1689

Shanghai
25th Floor, Tower II, Plaza 66
1266 Nanjing West Road
Shanghai 200040, China
Tel : +86 (21) 2212 2888
Fax : +86 (21) 6288 1889

Shenyang
19th Floor, Tower A, Fortune Plaza
61 Beizhan Road
Shenyang 110013, China
Tel : +86 (24) 3128 3888
Fax : +86 (24) 3128 3899

Shenzhen
9th Floor, China Resources Building
5001 Shennan East Road
Shenzhen 518001, China
Tel : +86 (755) 2547 1000
Fax : +86 (755) 8266 8930

Tianjin
Unit 06, 40th Floor, Office Tower
Tianjin World Financial Center
2 Dagu North Road
Tianjin 300020, China
Tel : +86 (22) 2329 6238
Fax : +86 (22) 2329 6233

Xiamen
12th Floor, International Plaza
8 Lujiang Road
Xiamen 361001, China
Tel : +86 (592) 2150 888
Fax : +86 (592) 2150 999

Hong Kong SAR and Macau SAR

Hong Kong
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

23rd Floor, Hysan Place
500 Hennessy Road
Causeway Bay, Hong Kong
Tel : +852 2522 6022
Fax : +852 2845 2588

Macau
24th Floor, B&C, Bank of China Building
Avenida Doutor Mario Soares
Macau
Tel : +853 2878 1092
Fax : +853 2878 1096

Ignition and Start-up Centres

KPMG Digital Ignition Centre
21st Floor, E07-1 Tower
Suning Intelligent City
272 Jiqingmen Street
Nanjing 210017, China
Tel : +86 (25) 6681 3000
Fax : +86 (25) 6681 3001

KPMG Innovative Startup Centre
Room 603, 6th Floor, Flat B
China Electronic Plaza
No. 3 Danling Street
Beijing 100080, China
Tel : +86 (10) 5875 2555
Fax : +86 (10) 5875 2558

kpmg.com/cn

Publication number: HK-TAX18-0001

Publication date: January 2018