China requests more data from large businesses under the 'Thousand Groups Project'

10 November 2016

In brief

On 20 July 2016, the Taxation and Fiscal Committee of the Business and Industry Advisory Committee to the OECD (BIAC) published meeting minutes from discussions with China's State Administration of Taxation (SAT) about its 'Thousand Groups Project' (the Project).

The SAT launched the Project in late 2015 as a revolutionary initiative to solve, by 2020, perceived problems of information asymmetry and to enhance its capability and efficiency with respect to large businesses, via data mining and analysis. One of the Project's key features was to collect a full set of financial, tax and accounting data from about one thousand large business groups operating in China. The Project was devised and led by the Large Business Administration Department of the SAT (LEAD). Initially, this Project caused great concern among the business community, especially multinational corporations (MNCs), because the Chinese tax authorities could request data that covered a wider area and was more detailed than reported tax information. Such requests could go beyond information that was necessary for tax administration purposes. In addition, complying with such requests not only would test in-house tax teams' responsibilities, but would also require the attention and participation of a large business group's other functions in order to preserve the integrity of its overall tax information and control systems.

In the first half of 2016, BIAC and other business chambers visited the LEAD to express the concerns of the large business communities, in particular foreign-invested MNCs. As reported in BIAC's meeting minutes, the LEAD gave feedback positively and constructively to address those concerns.

Matthew Mui, leader of PwC's China National Tax Policy Services, and Philip Greenfield, member of PwC's Global Tax Policy & Administration, share below their observations on the Project in China. They also address the trend of tax administrations around the world using data to meet their goals.

In detail

Background of the 'Thousand Groups Project'

China has made significant efforts to administer its large tax contributors. This began in 2008 when the SAT set up the LEAD and gradually introduced a complete tax administration facility for large businesses operating in China. With the economic growth and the recent use of digital technology, China, like many other jurisdictions, is transforming to a new risk-based and data-driven tax administration approach.

Specifically, in 2015, the SAT launched an 'Internet + Taxation' programme to expedite the digitalisation of tax administration and tax services.

Following that, a *Plan on Deepening the Reform of Tax Collection and Administration System of State Tax Bureaus and Local Tax Bureaus* (Reform Plan) was released to introduce a new tax administration mechanism. Here, taxpayers are categorised according to their size and industry, and subjected to different levels of tax risk management by the Chinese tax authorities. Consequently, companies with a higher tax risk would more likely be subject to more comprehensive and frequent tax audits.

At this turning point, the SAT kick-started a revolutionary initiative, i.e., the 'Thousand Groups Project' in late 2015. The SAT selected about one thousand groups in different Chinese regions to centralise their tax risk management at the SAT level and requested that they provide their financial, accounting and tax data. The selected targets are the largest business groups in China in terms of business size, tax contribution, turnover, etc. They include large foreign-invested MNCs, state-owned enterprises and domestic private companies. According to the Reform Plan, going forward the local-level tax bureaus in charge of these large businesses should continue to handle these groups' routine tax administration (such as tax filing). However the SAT or the provincial tax bureau level (as opposed to municipal tax bureau or even lower levels) will conduct the tax risk analysis.

Initially requested data

Initially, the Project's planned data request covered various types of company information, beyond those typically provided to tax authorities during the course of normal tax filing or reporting. In particular, the request included not only tax data, but also financial and accounting information. Furthermore, the request was not just for high-level reports and statements, but also for detailed accounts, ledgers, vouchers, business contracts, documentation, etc.

The BIAC's meeting summary indicates that businesses were allowed to choose one of two options for transmitting this data to the Chinese tax authorities:

1. install designated software provided by the SAT onto the company's systems to extract data or
2. use the SAT template to develop the company's own software to collect the required information and then upload the data manually to the tax authorities' platform.

Whether Option 1 might imply Chinese tax authority access to a large business's internal systems was uncertain. However, the SAT subsequently clarified that their software did not feature such aggressive functionality. Businesses should still be able to instruct their systems as to what information to provide or not provide.

Large businesses were originally required to provide their data by the end of March 2016. This was an impossibly tight deadline for many large businesses, leaving some with no more than one month to comply.

Q&A

Based on your observations, would MNCs be willing to provide such data to tax authorities?

Matthew – As far as we understood, many large businesses found the LEAD's requirements for data confusing. The LEAD published no clear written policies. Instead, businesses just received verbal instructions from their in-charge tax bureaus. Then they received the SAT's designated software.

Businesses also were not certain of the data collection's legal basis. In general, the legal basis for tax authorities to collect taxpayers' data is stipulated in the prevailing *Tax Collection and Administration Law*, which empowers tax authorities to collect data during the prescribed tax filing and tax audit procedures on an as needed basis, examining their accounting entries and vouchers, accessing their accounting system and copying relevant data. However, the data collection under the Project, with its breadth and depth of coverage, obviously extended beyond the normal tax filing and tax audit process.

Apart from the legal basis issue, many large businesses might have other practical concerns, such as business confidentiality. Leakage of the requested data or other data through the collection process could expose commercial secrets and sensitive transactions.

In addition, internal control policies might not allow a China entity's in-house tax department to access the global group's financial data, or accounting data, or alter its IT systems to comply with the SAT's particular requests. Sometimes this resulted in tensions at the local level among company departments, as well as between the China entity and global / regional headquarters about how to comply.

Interestingly, some large businesses did not find the LEAD's request unreasonable. It motivated them to improve their internal tax information and control systems in order to participate in the big (tax) data trend.

Philip – There was lack of clarity about what requests had been made and why. Many suggested that it was part of China's response to the OECD / G20 Base Erosion and Profit Shifting

(BEPS) project and was specifically for the purposes of assessing BEPS. Some reported what they had heard from companies that had received requests to allow the SAT to download large amounts of data via a USB/ pen drive from their financial accounting systems. It wasn't clear who had been asked for the information and whether others would also be asked.

Most large businesses, representative organisations and advisers expected that the highest levels within the SAT would have announced any approved exercise to make such an unusual and apparently wide-ranging request.

Further, the Forum on Tax Administration (FTA) had scheduled a meeting in Beijing on 11-13 May 2016. Multinationals were aware that FTA participants had been working on a number of projects. Whether the information request had something to do with this work, given the apparent focus of some of that work on use of analytical techniques or technological advances (a number of publications were later released at that event to shed more light on that work) was uncertain.

Large businesses were very keen to understand what was involved.

How did the SAT respond to these concerns?

Matthew – The Project's vision makes it more than a pure tax compliance or administration initiative. For example, agencies can also use the data collected for macro-economic analysis as part of national strategies and non-tax policies. The Project was launched in a rather low-key manner and, initially, was not sufficiently transparent to large businesses. However, we observed that during the implementation, the LEAD was actively listening to various stakeholders' feedback, exploring room for improvement and adding flexibility to fine tune the Project.

As reported in the BIAC July meeting summary, the LEAD agreed to "narrow the information request to financial and accounting data at the 'report' level, rather than the detailed transaction level; and rescheduled the due date for delivery of the data to the end of 2016". The LEAD also reiterated that "the information collected will be held strictly confidential within the SAT and can only be decrypted by the SAT database system".

There has been no indication that the SAT / LEAD would suspend the Project, but they are allowing more time for large businesses and themselves to implement the data transfer in a more harmonised manner.

After collecting the data, what's next?

Matthew – 'Big data' is a mega-trend. The tax, financial, and accounting information collected under the Project should become a rich source for the SAT's data pool. But data collection is only the first step. Following that, the LEAD / SAT will analyse the data to determine useful parameters, thresholds or benchmarks by period, location, size, industry, transaction, investors' country, etc.

For tax purposes, such analysis could help the Chinese tax administration predict tax collection, pinpoint common tax risk areas of certain industries or specific risks of certain companies, and identify 'suspects' for tax non-compliance. In due course, companies may receive follow-up inquiries from tax officers. From a macro-economic perspective, the data could also be used to optimise the deployment of tax administration resources, analyse major economic trends and facilitate policy making.

As a member of PwC's Global Tax Policy & Administration, have you seen other countries or organisations use a similar approach for analysing large companies' tax reporting?

Philip – Analysis of data or content has advanced from human observation to the advanced analytical tools of today. Those tools use sophisticated approaches such as pattern recognition, outlier detection, cluster analysis, experimental design, network analysis, and text mining. The volume and type of data that countries have sought from specific taxpayers have grown and the capabilities for review have emerged.

Thus far, few countries have adopted strategies that require large data transfers from taxpayers. Brazil is a notable exception. With its SPED system (the Public Digital Bookkeeping System), Brazil has, in recent years, required most companies to send bookkeeping and digital information electronically to the tax authorities. This request includes calculations with respect to transfer pricing, certain tax credits, social security contributions and income tax, among others.

Smaller datasets are often used for similar purposes. The FTA reports that the US "addresses the problem of data 'representativeness' by making extensive use of data from randomly selected audits (which are unbiased representations of the population) in order to develop its case-selection methodologies" . On the big data theme, Singapore has consolidated information from a variety of different sources into a central database "in a format that is suitable for predictive modelling and other advanced analytics uses".

A number of countries have attempted to interrogate datasets for VAT compliance and, in particular, to detect fraudulent claims. Countries that have requested access to data in order to perform such checks have included the UK, Ireland, Mexico, the Netherlands and a number of Scandinavian countries. Many countries have more recently adopted the SAF-T (standard audit file for tax) which the OECD has defined, along with recommended tests to perform. Russia has gone further with big data in relation to VAT compliance and, for instance, has the capability of linking transactions to trace compliance at each stage in a value chain. The Czech Republic has recently confirmed a phased introduction of an electronic records of sale (EET) system which will require online uploading of transaction records at the point of sale/ payment. A number of South East Asian countries are apparently carrying out social network analysis (SNA) which identifies the connections between 'actors' to help detect VAT carousel fraud.

The takeaway

Matthew – The SAT's ultimate goal is to build and adopt a tax risk-based administration system via data mining and data analysis on a real-time basis by year 2020. With modern IT advancement, the Chinese tax authorities will be able to export taxpayers' data on a more timely and efficient basis. So I believe the Project is a landmark trend being established by the China tax authorities. I think that other tax administrations around the globe may follow once the SAT / LEAD proves it effective. Going forward, tax administrations will continue to expand their data pool to unlock the power of technology and improve their risk-based and data-driven tax administration system. In response, MNCs might consider deploying more technology resources to their financial and tax systems to enhance their data management and analysis capability (also part of their internal control systems). This would enable them to comply with the increasingly complicated data requests by various tax authorities.

In addition, the Project would inevitably involve not only in-house tax departments, but also legal, IT, public relations, human resources, and many other company / group functions. The taxpayer has to strike a balance between helpful, voluntary and co-operative tax compliance and commercial confidentiality. Therefore, we suggest a top-down and multi-function collaboration approach to ensure that appropriate and consistent information is provided cautiously, timely and efficiently to the tax authorities.

As mentioned, following the data collection exercise, the SAT / LEAD likely will look into the details to identify the tax risks of each large business. A mature internal tax control system, including regular tax risk reviews, should help MNCs withstand potential challenges.

Philip – Large businesses from which the China tax authorities request data under the Project should be more encouraged by the responses BIAC received to its questions and by Matthew's insights.

As we have repeatedly suggested during discussions of greater tax transparency, even where the tax administration keeps information confidential, businesses need to consider what inferences readers may draw from any additional data provided and be prepared to explain 'the whole story'.

While the current data will be used for broader economic profiling, it may also mark a potential step toward a more open and co-operative relationship in tackling compliance in the future.

Let's talk

For a deeper discussion of how this might impact your business, please call your usual PwC contact. If you do not have a contact or would prefer to speak to one of our global specialists, please contact one of the individuals below:

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