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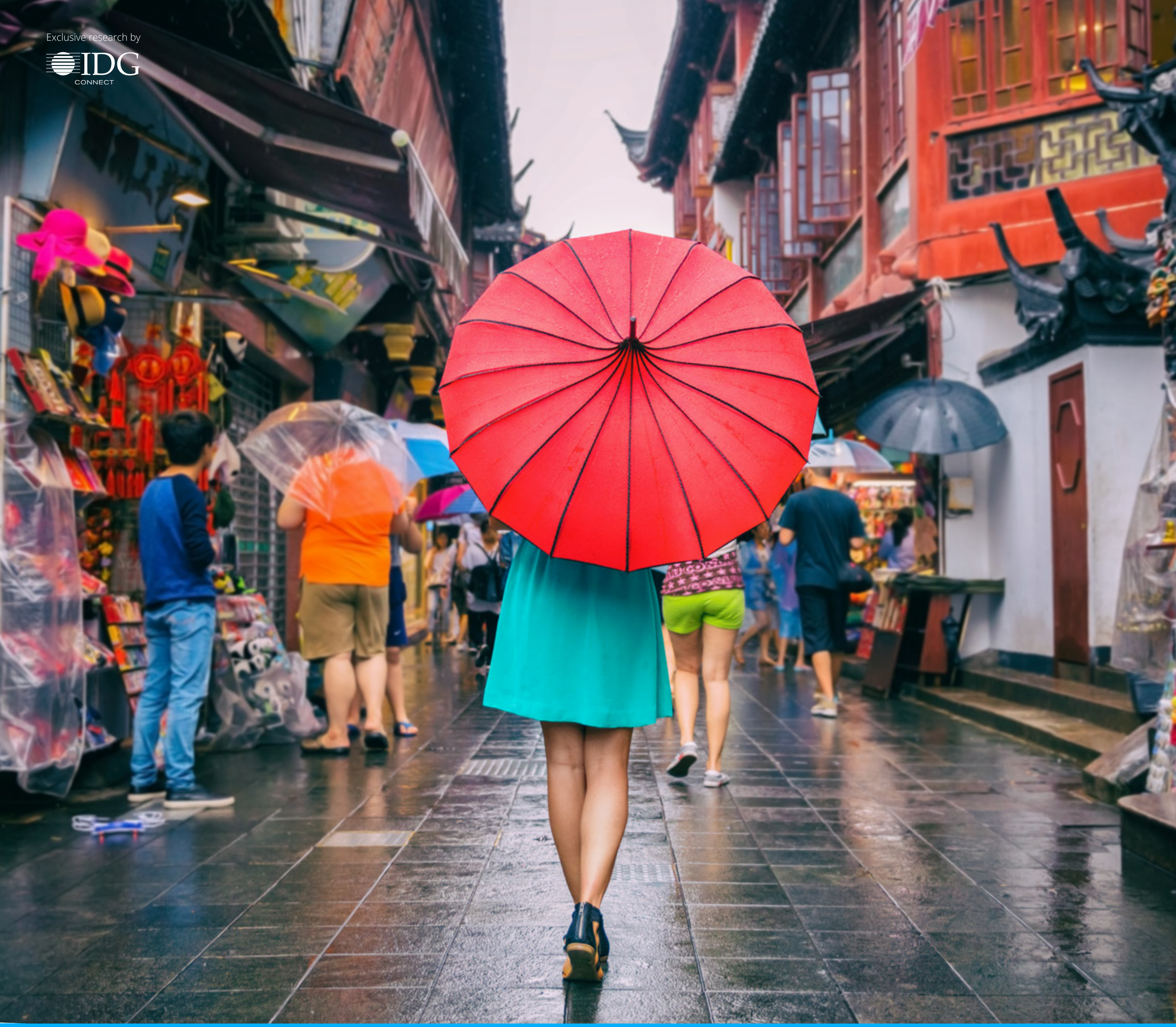

Golden tax, fapiaos and culture: How to behave like a local in China

Growing business in China can be challenging but reforms and direct access to the tax system are bringing the country in-line with international best practice.

TRADESHIFT

Introduction: The China syndrome

Speaking in 2005 to the Academy of Social Science in Beijing, former UK Chancellor of the Exchequer, Gordon Brown outlined the significance of China to the world economy. China, he said, "has been responsible for keeping the world economy growing, as the advanced industrial economies went into a downturn. China has itself contributed more growth to the world economy in the last few years than all the G7 combined."

Brown, like many world financial leaders at the time, predicted the unwavering growth of China, its meteoric rise to economic superpower and the implications for businesses in the UK and Europe. Admiration was understandable, but China's growth also provoked fear and uncertainty.

As Lord Wei outlined to the UK parliament in 2014, doing business in China and attracting inward investment from China has its cultural and practical challenges.

However, in more recent years, China has done a good job to reform and make it an easier place to do business. The World Bank claims China is now ranked 46th among 190 economies in the ease of doing business (up from 78th in 2017).

The bottom line is that China needs international trade. To sustain its economy in the long-run, it knows it must adopt wide-ranging reforms, if anything to avoid the typical slowdown of a middle-income nation – although Stephen Roach argues that China will avoid the middle income trap from the shift from quantity to quality.

Nevertheless, whether the country meets its long-term objectives is by no means certain. While President Xi Jinping claimed at Davos in 2017 that China "should guide economic globalisation, cushion its negative impact and deliver its benefits to all countries", there has been slow progress, hampered by global economic slow-down and a trade tariff spat with the US.

If anything, though, this has added more impetus to China's economic agenda. The country's refocus on business and structural reforms and opening-up more to global trade, according to the South China Morning Post, should encourage outside investment. Certainly, there has been considerable progress.

As World Bank Group president Jim Yong Kim revealed last year, China has made great strides in improving its business practices.

However, there is still a long way to go. Doing business in China remains challenging and processes, such as the Golden Tax and fapiao e-invoicing systems, are still difficult to manage. While western businesses are understandably attracted to working more closely within the Chinese market, overcoming the barriers of culture and regulatory complexity are essential for long term success.

Down to business

The problem any company has when it comes to either cross-border trade or running operations within another country, is whether or not it can operate under a set of best business practices. Understandably, each country will have its own cultural quirks, and while the World Economic Forum's (WEF) Doing Business guidelines go some way to levelling the field, China has been something of a special case.

China, for all its assumed controls and restrictions, publicly recognises the value of a global digital economy. For one, it has avoided dividing the business world into two digital infrastructures by engaging in conversations with other G7 nations on digital reforms, as the WEF outlined in its report, Our Shared Digital Future. This evolution in mindset has enabled the implementation of digital practices, opening up the market to international business.

In 2016, the Chinese government implemented significant tax reforms, culminating in the new Golden Tax System, a system designed to digitise VAT compliance, notably the authentication of e-invoices (faipiaos). The new system, commonly referred to as GTS III, means increased scrutiny of tax returns and registration forms, including disclosure of individuals' benefits-in-kind and monthly salary.

Although intended to simplify the VAT process, it is still very complex, especially for foreign subsidiaries. The process is different from other countries and is still very manual and paper-based, driven as much by culture as government dictate. For European businesses this has challenges and impacts. China's VAT system remains difficult to master, as there remain multiple tax levels and exemptions. While e-invoicing was ushered in to improve transaction compliance and visibility, the reality is that it is only part of the solution as invoices still have to be printed and handled physically.

However, what these changes have meant is that European businesses can now start to bring the Chinese market closer to global operations. The door has opened but only because some global organisations have established footholds through partnerships, providing direct access to the GTS.

5 Steps to e-invoicing success in China

For any business already operating in China or for those looking to enter the market, getting to grips with e-invoicing and the VAT tax system is fundamental to success. Here are the five challenges that need to be overcome.

1 Integration

– how can the business integrate global e-invoicing and EDI infrastructures to ensure compliance with Chinese VAT system?

2 Culture

– while reforms have meant change, traditional practises, such as IOU notes still exist. How can organisations see China through China's eyes and marry tradition with modernisation?

3 Transparency

– how can European organisations have full visibility of subsidiaries, including tax liabilities and compliance?

4 Managing payments

– what is the right technology to manage payments? How can organisations ensure secure, scalable payments technology that is compatible with customers and suppliers?

5 Communication

– as well as obvious language barriers, how do businesses get to grips with local business etiquette and secure communications technologies?

Growing opportunities

To operate effectively and efficiently in China, European businesses need the following:

1 Digitisation

100% accuracy by retrieving invoice and tax data through direct access to the tax system

2 Compliance

Data validation to ensure compliance through a direct connection to the GTS, ensuring transparency

3 Automation

invoice and payment tracking

For any organisation that wants to embrace China, bring it into its global operation and no longer treat it as a separate entity, a switch to e-invoices will reduce the cost of producing, printing, transferring, and storing invoices but not replace them. While paper fapaios are still required, digitisation helps optimise processes around VAT compliance and reporting, invoice approval, and accounting.

This means organisations can reduce complex arrangements with scanning and printing bureaus, move away from manual importing and inputting and speed up invoice processing workflow. By combining compliant invoice issuing capabilities with business interactions and collaboration, businesses can optimise document processing, ensure transparency in transactions and enable buyers and suppliers to work more closely.

What this really means to European organisations is an opportunity to grow business in China and with Chinese partners, while ensuring compliance with government regulation.

The VAT reforms

While the Golden Tax System and fapiao heralded the modernisation of doing business in China, the country's tax system is subject to almost annual reform now. In 2018, the Chinese government implemented three more significant measures to further reform the VAT system - it's estimated that these series of reforms have helped the largest Chinese companies reduce their tax burden by RMB 400 billion ($58 billion) in one year. Furthermore, the simplified system has allowed small and medium-sized enterprises to reduce their accounting, tax filing, and tax burden.

In April 2019, further reforms were implemented, including tax rate reductions for certain services and refund mechanisms. However, as a KPMG report identifies, "unlike many other countries, China still does not allow foreign entities to register for VAT and claim VAT credits or refunds on costs incurred."

Therein lies another complexity. The tax system still has a long way to go to adhere to the OECD principles on taxation but it is getting better. While the tax system is closer aligned with international tax systems and practices, on-going reform demands local knowledge and technology that can facilitate changes as and when they occur.

Future view: China in your hands

There is an old Chinese proverb that says, “dig the well before you are thirsty,” suggesting that preparation is everything. While operating subsidiaries in foreign nations can be daunting, China demands more attention than most. There are still significant challenges but there are also significant rewards, from a market that in 2018 grew twice as fast as the US.

China will continue to reform its practices to encourage business development and growth internationally, while at the same time clamping down on tax avoidance and fraud. From April this year VAT was cut for a number of business sectors but it came with caveats. It’s done nothing to unravel the complexity. What is clear is that China will continue to change and evolve its taxation and compliance demands, sometimes in unpredictable ways.

Any business that wants to operate in the region has to accept this evolution and try to navigate the changes quickly and efficiently. However, to date, most global organisations working in China have had to have two separate systems – one for global and one for China. This no longer needs to be the case. Working with a partner that has direct access to the GTS will revolutionise doing business with China. It will trigger process reforms that will stand any business in good stead for now and in the future.

While China is still focussed on paper, the reality is that it is increasingly embracing digital processes and it is only a matter of time until its complex VAT invoicing system will go fully digital. Until that time, businesses have a clear choice – keep things as they are and struggle with compliance and scalability, or start moving towards a digital solution that enables streamlined processes and globalisation. Dig that well.

Why Tradeshift?

Tradeshift's localised, e-invoicing platform for all paper VAT invoices, is fully compliant with Chinese tax and invoicing rules.

Tradeshift can provide customers with unique access to VAT paper invoices in the Golden Tax System. This means we can help businesses meet cloud-driven tax compliance and reporting requirements, easily and automatically, while enabling transactional visibility and transparency.

With real-time access to the data, organisations can then fully understand their tax-related financing needs and drive corporate liquidity/credit through ecosystem participants.

Tradeshift offers capabilities through a customized, hosted Chinese Tradeshift platform that can be accessed over different web clients, including mobile apps.

Organisations can also gain better visibility of global transactional document flow and information. They can build supplier ecosystems within the region to encourage growth and invest with confidence.

TRADESHIFT®

Tradeshift drives supply chain innovation for the digitally connected economy. As the leader in supply chain payments and marketplaces, the company helps buyers and suppliers digitize all their trade transactions, collaborate on every process, and connect with any supply chain app. More than 1.5 million companies across 190 countries trust Tradeshift to process over half a trillion USD in transaction value, making it the largest global business network for buying and selling. Discover commerce for all at tradeshift.com

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