

(Vol. 4)

# Peking University Journal of Legal Studies

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Economic Integration in East Asia: The Path of Law

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## Editors' Foreword

"Diversity" might be the first impression when reading this forth volume of Peking University Journal of Legal Studies. Not only are important domestic issues such as Golden Tax Project and water supply analyzed, but areas with regional or global significance are also explored. A variety of different economic and political development issues, including tax policy, the rise of modern state-owned big business, judicialization campaign and constitutionalism, are considered. The scholarly depth of the papers is clear, and their perspectives may help to shed light on different aspects of developments in China, even if those perspectives may not be shared by the Journal's editors. This Issue also includes analysis of legal developments related to social and technical topics that may also have a significant impact on Chinese society even though they are narrow in scope. One such article describes a new phenomenon; the Real Name System (RNS) in Chinese cyberspace, and another provides an update on Chinese family law by revisiting an intriguing concubine case.

Unlike the United States, where sales tax is a common form of indirect tax, almost all countries around the world—both developed and developing alike—now impose a "value added tax" (VAT). Jane K. Winn and Angela Zhang's *China's Golden Tax Project: A Technological Strategy for Reducing VAT Fraud* examines VAT in China. In the early 1990s, as part of its comprehensive economic reform program initiated over 30 years ago, the People's Republic of China implemented a VAT. Monitoring compliance with VAT is a serious challenge in developing countries, and China is no exception in that regard. To address this challenge, China launched a major fiscal reform project called the

“Golden Tax Project” (GTP) which mandates the use of specific sophisticated information technologies to improve compliance with China’s VAT laws. Although the Chinese GTP requires the use of information technology which can be considered as a form of “e-invoicing”, the focus is on creating a centralized matching system under the control of the tax authorities to reduce the incidence of fraud. In the EU, by contrast, the 2009 Report by the Expert Group on e-invoicing focused on strategies for increasing the voluntary adoption of e-invoicing technologies among taxpayers in order to make EU businesses more competitive. The Chinese policy requires stronger central controls than the EU policy, and includes stringent, new mandatory taxpayer duties, so it would not be suitable for use in developed economies with relatively high rates of voluntary compliance. The Chinese GTP strategy might provide a useful model for other developing countries struggling with large-scale, with widespread VAT compliance problems, however.

Granting concessions to private parties to exploit certain market opportunities is a public policy intended to supersede “natural monopolies” with competition. Wei Yan & Wang Chih-Cheng’s *Market Entry in China’s Water Supply Concessions: From a Comparative Study of UN and EU* examines China’s water supply concession experiences, and identifies the current market structure and concessionaire selection practice. The authors outline both domestic and international explanations for restricted competition and contend the “state-owned enterprise” model must be distinguished from the model of pure concessions in market entry. The legal institutional response to this phenomenon requires transparency and due process in concessionaire selection.

Guo Rui’s *The Creation of Modern State Ownership: Legal Transplantation and the Rise of Modern State-owned Big Businesses in China* focuses on the state ownership in Company Law of China. Although many legal elites believe that Western-style private ownership is the right way for Chinese corporations to benefit from competition, China seems to have a strong preference for continued state ownership of major enterprises. This research shows how the Company Law of 1993—the most recent transplanted Western-style corporate law—has fostered the emergence of modern state-owned big businesses from State-owned Enterprises (SOE), and how it eliminated alternative choices that would have di-

rected China towards Western-style private corporations along its way. The Company Law of 1993 has thus paradoxically strengthened state ownership of big Chinese businesses, which in turn has fueled the emergence of a China form of economic development.

The state-owned businesses are scrutinized by Miao Yinzhi from another angle. His article, *The Governance Effect of Oversea Listing on the Chinese SOEs: The Role of the State Matters*, claims that: overseas listing has been widely regarded as very useful for the governance of Chinese state-owned-enterprises (SOEs), however effective as it may be, such movement could not be a marvelous antidote to all governance ills in SOEs. Further, major disasters in two overseas listed firms show that inner SOEs governance pathologies may remain and be influential. And it is more likely that such firms would be bailed out, causing more governance problems in the overseas capital market. Hence the government should think more about its proper role in handling SOEs so that overseas listing would not amplify potential negative governance results happening in such firms. The ultimate function of this institution for corporate governance of SOEs thus relies heavily on public governance.

The passing decade has witnessed the campaign for the "judicialization" of China's Constitution landscape, which was launched and sustained by a loosely-knitted coalition formed among senior judges, elite lawyers and liberal scholars. Tian Lei's *In Search of China's Marbury: Why the Judicialization Campaign Failed and How to Revive Constitutionalism in China*, first presents the basic parameters defining constitutional discourse in China, and then provides a summary of the decade-long struggle triggered by the Qi Yuling decision, the so-called first constitutional case in P. R. China, from the perspective of constitutional politics. Casting new light on this debate by deploying "thick description" as an analytic form, the article provides a significant reinterpretation of the causes of the failure of this dramatic constitutional movement, as well as a vision to inspire Chinese constitutionalists in their future endeavors. The author argues that instead of the routes of judicialization, privatization or regime transformation, the nationalization vision, in which the Constitution is taken as the fundamental national document to balance between national unity and local diversity, could provide a workable and practical way to better integrate the Constitution into the



political regime of the P. R. China.

Unlike other British colonies, Hong Kong was ruled autocratically by the British colonial authorities for over one and half centuries of the colonial history. To strengthen their colonial governance, the colonial authorities used the appointment system to form the Legislative Council, instead of introducing electoral elements. Niu Yue's *The Autocratic Governorship, Functional Constituencies and the Continuity of Paternalism in Colonial Hong Kong* emphasizes justifications for this tradition, which was legitimized through the paternalism of the colonial authorities. In the last decades before handover, however, the colonial authorities designed a novel system of functional constituencies to return part of Unofficial Members to the Legislative Council. Instead of a fundamental representative reform, the author argues that the system of functional constituencies reflects the continuity of paternalism.

Henry L. Hu's *Real Name Systems in Chinese Cyberspace: Authentication, Privacy and State Capacity* describes a new word in China: Real Name System (RNS), a vague concept in the Chinese contemporary context. Of course, the term "Real Name System" literally refers to conducting certain activities in the name of the genuine person himself without disguise or pseudonym. The operation of this policy in China is more complex than that, however. So far, there have been five main forms of Internet RNS: Internet Cafes, Campus BBSs, public forums, Internet games and blogs, each of which may give rise to concerns with privacy and free expression on the Internet. This article first describes the development of each RNS chronologically, noting their different backgrounds, functional mechanisms and effects. Next, the author describes ideal conditions for implementing RNS based on a comparison of successful and unsuccessful RNS practices. Protection of minors and regulation of harmful speech are considered as justifications for RNS policies. The author concludes by arguing that not only is it difficult to balance public order and individual freedom issues within an RNS policy, adopting an RNS policy is actually unnecessary because of the many existing ways of tracing and restricting one's online activities, so more attention should be paid to the protection of personal data China instead.

Ding Xiaodong's *Beyond the Liberal Understanding of the Chinese Family Law: the Concubine Case Revisited* provides a careful study of

Chinese family law. One modern concubine case is shown to embody two different views toward the individual and the family. Modern family law experts tend to view the individual as the basic unit of the law and the society, while ordinary people in China tend to view the family as an ethical community that should be protected by the law. A close look at history shows us that the traditional Chinese approach is more complex, with three different traditions within Chinese family law that have greatly shaped popular attitudes toward family issues. In both the Confucian and Socialist traditions in China, family was seen as some kind of ethical community, while in the liberal tradition, family was based on contracts not unlike business contracts made by individuals as the basic unit of society. To have a fuller understanding of Chinese family law, the author argues that we should look beyond the liberal understanding and have a more comprehensive perspective toward Chinese family law.

Zhang Zhiyong's *Economic Integration in East Asia: The Path of Law* analyzes the role of law playing in East Asian economic integration. The impressive economic performance of East Asian economies and the achievement of economic integration in East Asia before the financial crisis of 1997—1998 were more attributable to the governments' strategic actions and to market forces, than to the law. However, the weakness of domestic legal systems and the lack of regional legal mechanisms caused problems for East Asian economies in 1997—1998. In the aftermath of that crisis, East Asian economies have both strengthened governance and supervision at the domestic level, and also made significant progress in areas such as trade, investment and monetary cooperation at the regional level. ASEAN, being the driving force of regional integration, is gradually shifting from being an organization based on political dialogue to one with an international legal personality, capable of being involved in binding commitments. The complex situation of East Asia may require a specific mechanism to be designed for deeper economic integration, however. No matter what kind of approach is adopted, there is no doubt that the rule of law will ultimately safeguard East Asian economic integration.

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## **China's Golden Tax Project:**

### **A Technological Strategy for Reducing VAT Fraud**

**Jane K. Winn\* & Angela Zhang\*\***

#### **Abstract:**

Unlike the United States, where sales tax is a common form of indirect tax, almost all countries around the world—both developed and developing alike—now impose a value added tax (VAT). In the early 1990s, as part of its comprehensive economic reform program initiated over 30 years ago, the People's Republic of China implemented a VAT. Monitoring compliance with VAT is a serious challenge in developing countries, and China is no exception in that regard. To address this challenge, China launched a major fiscal reform project called the “Golden Tax Project” (GTP) which mandates the use of specific sophisticated information technologies to improve compliance with China's VAT laws. Although the Chinese GTP requires the use of information technology which can be considered as a form of “e-invoicing”, the focus is on creating a centralized matching system under the control of the tax authorities to reduce the incidence of fraud. In the EU, by contrast, the 2009 Report by the Expert Group on e-invoicing focused on strategies for increasing the voluntary adoption of e-invoicing technologies among taxpayers in order to make EU businesses more competitive. The Chinese policy requires stronger central controls than the EU policy, and includes strin-

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gent, new mandatory taxpayer duties, so it would not be suitable for use in developed economies with relatively high rates of voluntary compliance. The Chinese GTP strategy might provide a useful model for other developing countries struggling with large-scale, widespread VAT compliance problems, however.

## Text:

### I. INTRODUCTION

In 2009, this advertisement for fake tax invoices, printed on a 2-inch by 3 ½-inch sticker, was stuck to the sidewalk near Dagu South Road in Tianjin [ Pinyin transliteration and English translations have been added ] :

刻章办证上网发票 (Ke Zhang Ban Zheng Shang Wang Fa Piao)

[ Make chops Manage certificates Internet access Invoices ]  
136-2208-6552

代开医院门诊票住院票机打票 (Dai Kai Yi Yuan Men Zhen Piao Zhu Yuan Piao Ji Da Piao)

[ Outpatient invoice Inpatient invoice Machine printed invoice ]<sup>[1]</sup>

These stickers are a familiar sight in Chinese cities—they have been stuck to the sidewalk by criminal enterprises in the business of printing fake diplomas, certificates, invoices and other business documents. Given the patently illegal nature of the services being advertised, the phone numbers are only temporary mobile numbers that cannot easily be traced. The value of the fake invoices depends on how they are used: phony invoices for medical treatments may be used to obtain fraudulent reimbursements for medical expenses, while phony business expense invoices may be used to evade taxes.

The widespread use of such stickers to advertise illegal services highlights a problem that China shares with most other developing coun-

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[ 1 ] On August 8, 2009, the mobile phone number listed on the sticker had already been disconnected. The original sticker is on file with the authors.

tries; the difficulty of increasing compliance with modern regulations, including tax laws. This paper will focus only on tax law as an example of modern regulation and only on one type of tax law in particular: value-added tax (VAT). In the early 1990s, the PRC adopted a VAT system as part of a sweeping package of fiscal reforms.<sup>[2]</sup> A VAT system requires businesses to pay tax on the difference between their revenues represented by invoices they have issued, less their expenses represented by the invoices of other enterprises they have paid.<sup>[3]</sup> The phony business expense invoices being advertised in the sidewalk stickers are presumably being used by legitimate businesses to fraudulently evade their VAT obligations.

Since China adopted the VAT system, tax authorities have responded with a variety of strategies to deal with the problem of large-scale VAT invoice fraud. One early strategy was to criminalize the activity and make it subject to the death penalty.<sup>[4]</sup> From time to time, Chinese authorities have launched campaigns to crack down on this form of

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[2] *Provisional Regulations on Value-added Tax* (1993, P. R. C.); for a description of China's fiscal reforms in the early 1990s, see generally, 刘佐 (Liu Zuo), 《新中国六十年税收大事辑选》 (Important Events of Taxation During the Past Sixty Years in the PRC), 《中国税务》, No. 10, 2009, pp. 4, 8—9; Barry Naughton, *The Chinese Economy: Transitions and Growth*, The MIT Press, 2007, p. 103; Jinglian Wu, *Understanding and Interpreting Chinese Economic Reform*, Texere, 2005, pp. 269—274.

[3] For an overview of the design and administration of VAT systems, see generally, Liam Ebrill, Michael Keen, Jean-Paul Bodin, and Victoria Summers, *The Modern VAT*, International Monetary Fund, 2001; Richard M. Bird and Pierre-Pascal Gendron, *The VAT in Developing and Transitional Countries*, Cambridge University Press, 2007.

[4] Article 205 of the PRC Criminal Law (1997) sets out that where offenders issue fraudulent VAT Special Invoices or other invoices used in the cheating of export VAT refunds or claiming input VAT credits, the offenders shall be sentenced to up to three years of imprisonment or criminal detention together with a criminal penalty ranging from RMB 20,000 to RMB 200,000. If the amount involved is large or the circumstances are serious, the offenders shall be sentenced to three to ten years of imprisonment together with a criminal penalty ranging from RMB 50,000 to RMB 500,000. If the amount involved is huge or the circumstances are serious, the offenders shall be sentenced to an imprisonment of more than 10 years or life imprisonment together with a criminal penalty ranging from RMB 50,000 to RMB 500,000 or confiscation of property. Article 32 of the Eighth Amendment to the PRC Criminal Law (1997) deletes the provision of "If the criminal offenders have swindled state property and the amount involved is huge and the circumstances are serious and have resulted in significant losses to the state, the criminal offenders shall be sentenced to life imprisonment or the death penalty or confiscation of property". As set out in article 206 of the PRC Criminal Law, where offenders forge or sell fake VAT

fraud, rounding up phony invoice vendors and executing them.<sup>[5]</sup> For example, in connection with VAT invoice fraud carried out in Chaoyang and Puning in Guangdong Province, 30 convicted of VAT fraud were given life sentences and 17 were given death penalties in 2001.<sup>[6]</sup>

While executing phony invoice vendors may briefly capture headlines in China, the policy has been controversial even in China.<sup>[7]</sup> The modern theory of criminal law suggests that the deterrent effect of a law is determined by the expected value of the punishment, which is determined by the probability of enforcement action being taken, and not simply the absolute severity of the sanction.<sup>[8]</sup> Given the low probability of the death penalty being applied even during an enforcement campaign, it should not be surprising that even harsh criminal penalties appeared to be having little deterrent effect in China. The enforcement goal of modern regulation is usually described as “optimal deterrence” or minimizing the harm of violations at the lowest administrative cost.<sup>[9]</sup> While harsh criminal penalties may be one significant PRC tax

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Special Invoices, the offenders shall be sentenced to up to three years imprisonment, criminal detention or criminal control together with a criminal penalty ranging from RMB 20,000 to RMB 200,000. If the amount involved is large or the circumstances are serious, the offenders shall be sentenced to three to ten years of imprisonment together with a criminal penalty ranging from RMB 50,000 to RMB 500,000. Where the amount involved is huge or the circumstances are very serious, the offenders shall be sentenced to an imprisonment of more than 10 years or life imprisonment together with a criminal penalty ranging from RMB 50,000 to RMB 500,000 or confiscation of property. Article 34 of the Eighth Amendment to the PRC Criminal Law (1997) deletes the provision of “where offenders forge and sell fake VAT Special Invoices, the amount involved is extremely huge and the circumstances are extremely serious (which has seriously damaged the economic order), the offenders shall be sentenced to life imprisonment or the death penalty together with confiscation of property.”

[5] 吕冰心 (Lv Bingxin), 《虚开增值税专用发票之罪》(Criminal Offence of Issuing Fraudulent VAT Special Invoices), 《法人》, No. 1, 2007.

[6] Li Heng, China's Biggest Tax Fraud Comes to Light, 19 Sentenced to Death, at [http://english.people.com.cn/english/200111/01/eng20011101\\_83672.html](http://english.people.com.cn/english/200111/01/eng20011101_83672.html).

[7] 李虎子 (Li Huzi), 《虚开增值税专用发票罪若干问题探析》(Analysis of Certain Issues Concerning Criminal Offence of Issuing Fraudulent VAT Special Invoices), 《河南公安高等专科学校学报》No. 4, 2007. 张智辉 (Zhang Zhihui), 《虚开增值税专用发票罪死刑当废》(Death Penalty on Issuing Fraudulent VAT Special Invoices Should Be Cancelled), 《法制日报》2003. 7. 3.

[8] Anthony Ogus, *Regulation: Legal Form and Economic Theory*, Hart Publishing, 1994, p. 91.

[9] *Id.*, p. 90.

compliance strategy, it is not the only one. In an effort to increase overall rates of compliance with its tax laws in a cost-effective manner, China has developed some novel strategies.

During the same time that the VAT system was adopted, PRC tax authorities also launched the “Golden Tax Project” (GTP) which mandates the use of specific sophisticated information technologies to improve compliance with China’s VAT laws. The goal of the GTP is to construct a centralized invoice clearing system that will permit the PRC tax authorities to detect and reject fake invoices in real time, and to quickly and accurately identify and apprehend the culprits issuing them.<sup>[10]</sup> The GTP was launched in 1994. The first two phases were completed in 2000 and 2003 respectively, and in 2009 the final phase was nearing completion.<sup>[11]</sup> If the GTP succeeds, then phony VAT invoices may soon cease to be one of the products offered by phony document merchants in China.

Although the significance of the GTP may not be obvious in the U. S. , which remains the only major developed economy in the world to reject VAT and continue to use sales tax, it might be obvious to other developing countries struggling with large-scale, widespread VAT compliance problems. In any VAT system, some form of control over the issuance and use of business expense invoices is essential to controlling tax fraud. As businesses that are liable for VAT migrate their administrative systems from paper to electronic systems, tax authorities around the world are struggling with the question of how to permit the use of electronic VAT invoices without increasing the risk of tax fraud.

Although there is no universally accepted definition of “electronic invoice” (e-invoice), in this article, the term will be defined as the automated process of issuing, sending, receiving, and processing invoice

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[10] 程丹(Cheng Dan),《金税工程(二期)征管效益综合评价研究》(Comprehensive Evaluation and Study of the Golden Tax Project (Phase II)’s Collecting and Administering Efficiency) (2006), Dissertation for Masters Degree in Management of Harbin Institute of Technology.

[11] Golden Tax Project, *China Daily*, August 25, 2009, at [http://www.chinadaily.com.cn/language\\_tips/60th/2009-08/25/content\\_8614902.htm](http://www.chinadaily.com.cn/language_tips/60th/2009-08/25/content_8614902.htm).



data by electronic means.<sup>[12]</sup> In recent years, tax authorities in many jurisdictions that have adopted VAT have become interested in e-invoicing for two reasons: first, reliable electronic systems for generating and storing VAT invoices might lower the cost of monitoring taxpayer compliance, and second, more widespread use of the kind of sophisticated business information systems capable of generating invoices automatically might increase the global competitiveness of local businesses.<sup>[13]</sup> If e-invoicing systems can accommodate both goals, then the result would be increased efficiency for both public and private sector actors handling VAT invoices. However, whether both public and private goals for migrating paper VAT invoice systems to electronic systems can be achieved simultaneously is unclear. What is clear is that in designing the GTP, Chinese tax authorities have focused their attention almost exclusively on the public goal of increasing compliance with VAT laws, while tax authorities in Europe have directed much more attention to achieving the private sector goal of increased efficiency of local business operations.<sup>[14]</sup>

While the Chinese approach to increasing VAT compliance may appear coercive and rigid to foreign observers, and some domestic commentators have expressed concerns about coordination, maintenance, and information security issues,<sup>[15]</sup> it also represents an innovative blend of information technology and administrative reform designed to support

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[12] Helmstone Electronic Invoicing Services Glossary, at [http://www.helmstone.co.uk/services\\_eInvoicing\\_Glossary.aspx](http://www.helmstone.co.uk/services_eInvoicing_Glossary.aspx).

[13] See generally, DG Internal Market and DG Enterprise, Final Report of the Expert Group on e-invoicing, November 2009 (hereinafter EU Expert Group Report), at [ec.europa.eu/enterprise/sectors/ict/files/finalreport\\_en.pdf](http://ec.europa.eu/enterprise/sectors/ict/files/finalreport_en.pdf).

[14] Trustweaver, Electronic Invoicing In and With China—Briefing Note, March 31, 2009, at [www.streamserve.com/upload/China\\_summary.pdf](http://www.streamserve.com/upload/China_summary.pdf); *EU Expert Group Report*, supra note 13.

[15] 吴晓宇 (Wu Xiaoyu), 《影响金税工程若干技术问题》(Some Technical Problems Affecting the Operation of GTP), 《涉外税务》, No. 1, 2003, pp. 19—25. 2003 (with four sub-systems, network coordination will be difficult; the system is not designed to promote the use of e-invoicing among taxpayers; monitoring at different levels of government and not in real time creates vulnerabilities that could be exploited by criminals; computer security requirements are not fully integrated into the system or its administration, e. g., it is unclear what the consequences would be for losing a GTP identity card; some of the software and hardware are based on older designs that may be less resilient than newer designs; a change in management procedures may not be sophisticated enough to accommodate changes in tax law and policy).