

# Case Study on Collaborative Efforts of Seven Authorities<sup>1</sup> in Shenzhen in Combating Value Added Tax Fraud

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**Abstract:** Value Added Tax (VAT) is a type of turnover tax levied on the value added during the circulation of goods (including taxable services). It is characterized by its incremental taxation and step-by-step deduction at each stage. As the regulations deepen, instances of VAT fraud have evolved into professional, complex, and large-scale schemes. Relying solely on the efforts of tax authority to address the challenge has proven to be insufficient, and it has become imperative to unite relevant authorities to enhance regulatory synergy and decisively curb the illegal trend of fraudulent invoicing and tax fraud, thereby protecting the fiscal revenue.

**Keywords:** Tax administration, co-governance, innovative collaboration, value added tax, export refund

## I. Background

Value Added Tax (VAT) is a type of turnover tax levied on the value added during the circulation of goods, services, and taxable transactions. In China, a production-based VAT was first piloted in certain cities in 1979. In 2016, Business Tax to VAT Reform was entirely completed, shifting China's VAT system from a production-based to consumption-based tax and expanding the scope of taxation to include the sale of goods, services, intangible assets, real estate, and imported goods. In line with international conventions, China employs VAT export refund policies to encourage foreign trade, enhance the international competitiveness of export-oriented enterprises, adjust the structure of foreign trade and industries, stimulate economic growth, and avoid the double taxation of goods and services.

According to Article 66 of the Law of the People's Republic of China on the Administration of Tax Collection, export refund fraud refers to acts that involve falsely reporting exports or using other fraudulent methods to acquire a state-approved export refund. Given the multifaceted processes and complexities involved in export operations, which require joint supervision by tax, customs and other authorities, a complete regulatory

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<sup>1</sup> Seven authorities referred to seven government agencies in Shenzhen, including Shenzhen Tax Service, Shenzhen Municipal Public Security Bureaus, procuratorates and courts of Shenzhen, Shenzhen Customs District, Shenzhen Branch of the People's Bank of China, and Shenzhen Office of the State Administration of Foreign Exchange.

chain has not yet been established among functional departments. Lawbreakers exploit loopholes to fraudulently claim VAT export refunds, which has eroded national fiscal revenue and tax equity. Additionally, instances of export refund fraud claims often intertwine with money laundering, smuggling and other crimes, disrupting normal foreign trade patterns. The resulting false trade data distorts national export statistics, impairs decision-making processes, and gravely jeopardizes national interests.

Since October 2021, the State Taxation Administration (STA), the Ministry of Public Security, the Supreme People's Procuratorate, the General Administration of Customs, the People's Bank of China, and the State Administration of Foreign Exchange have jointly launched a concerted crackdown on illegal activities of fraudulent invoicing and tax refund fraud. As of July 2023, a total of 3649 export enterprises have been inspected nationwide, and tax losses of RMB 14.42 billion have been recovered.

## **II. Problems and Challenges**

### **● Means of export refund fraud**

Shenzhen, a premier international port city, boasts a flourishing foreign trade economy. In 2022, its total foreign trade volume reached RMB 3.67 trillion, with exports accounting for RMB 2.19 trillion. Shenzhen has maintained its position as the leading mainland city in foreign trade for the 30th consecutive year. The favorable trade conditions in Shenzhen have also attracted lawbreakers to engage in export refund fraud activities. The Shenzhen Tax Service has consistently prioritized combating export refund fraud. Since 2022, in collaboration with other authorities, it has resolved 13 cases of export refund fraud, dismantled 47 criminal syndicates, and recovered RMB 4.55 billion in illicit proceeds. These cases reveal that export refund fraud activities primarily involve three crucial aspects: "fake export reporting", "fraudulent invoicing", and "fake exchange settlement".

(1) Fake export reporting serves as a prerequisite for obtaining an export refund. The export customs declaration is a document obtained by export companies after completing customs procedures. Offenders mainly acquire customs declarations that do not align with actual exports by misrepresenting goods under their name or falsely inflating the value of non-valuable goods. These fraudulent customs declarations are then submitted to the tax authority to claim rebates.

(2) Fictitious input invoices also play a pivotal role. To match the declared value and goods of their fake exports, criminal syndicates further conspire with groups that issue fictitious invoices. They acquire fictitious input invoices through simulated transactions, typically by paying for such invoices, with the objective of claiming an export refund from the tax authority. In order to make these operations appear more convincing, criminal groups often elongate invoice chains and disguise transactions at multiple levels to evade oversight.

(3) Fake exchange settlement serves as a crucial facade. In an effort to conceal the criminal act of false export reporting for fraudulent refund claims, fraudsters typically

employ underground financial channels for fictitious settlements of exchange to create a fabricated illusion of export. The syndicates forge fake trade dealings between a fictitious foreign entity under their control and domestic-controlled enterprises, using underground financial channels to transfer funds from within China to overseas. Subsequently, through the fabricated foreign enterprise, the syndicate facilitates deceptive foreign exchange payments to a domestic business, which then claims an export refund and handles the verification and write-off of foreign exchange proceeds to complete the fake exchange settlement.

- **Limitations of the tax authority single-handedly combating VAT fraud**

During the course of investigating the aforementioned cases, the tax auditing bureau of the Shenzhen Tax Service discovered that criminal syndicates have been engaging in tax-related illegal activities in a more discreet manner, within shorter time frames, and with finer specialization and up-to-date techniques. These activities encompass more links and longer chains, making it challenging for the tax authority alone to efficiently supervise and thoroughly investigate such illegal activities.

(1) Data from the tax authority is not enough to support comprehensive crackdown efforts. To address the strategies employed by wrongdoers, such as establishing fraudulent export companies, fabricating transactions to acquire fictitious invoices, forming overseas companies to sign false contracts, conducting false exchange settlements through underground financial channels, and colluding with illicit customs clearance agencies to purchase declaration forms, a comprehensive analysis and assessment require aggregating export information from customs administration, fund flow information from banks, settlement records from foreign exchange administration, etc. This entails analyzing the structure of syndicates, tracing individuals behind the scenes, and locating suspects in criminal investigations. Relying solely on the tax authority is insufficient to achieve timely and effective preemptive warnings, in-process supervision, and post-incident enforcement.

(2) Oversight by the tax authority falls short of achieving a whole-process crackdown. Export operations encompass multiple processes that necessitate collective supervision by several governmental departments. Solely relying on the tax authority cannot promptly and comprehensively gather data related to export refund fraud. For instance, in the case of fictitious trade activities, the customs administration must leverage its checkpoint advantages to enhance the oversight of exported goods. Similarly, for fake exchange settlement activities, the foreign exchange administration should enhance analysis of enterprise settlement data to promptly identify companies with abnormal settlement behaviors. Additionally, export refund fraud often intertwines with smuggling, underground financial transactions, money laundering, and other illicit activities, presenting a complex criminal landscape. Effective crackdown on tax fraud requires co-governance.

(3) Insufficiency of investigative methods also hinders achieving an in-depth crackdown. The tax agencies lack the authority to employ necessary investigative measures such as home searches, electronic monitoring and asset seizures. In cases where inspected entities

refuse to provide relevant account books and records, tax agencies are unable to conduct search and evidence collection at their production and operational sites. Furthermore, there are frequent cases of interference with inspections, elimination of evidence and direct escape. Consequently, investigating taxpayers' fraudulent activities and revealing criminal facts become challenging. There is also a lack of effective methods to trace the ultimate controllers hidden behind these operations. Inspection efforts can easily become passive and lose strategic advantage without timely intervention from law enforcement.

### **III. Case Analysis**

#### **●General Development Process**

The necessity for inter-departmental collaboration is particularly evident in the effort to combat export refund fraud. The STA of China has consistently been exploring mechanisms for cross-departmental cooperation. **In 2018**, the STA, the Ministry of Public Security, the General Administration of Customs and the People's Bank of China jointly launched a two-year special operation to combat fraudulent invoicing and tax fraud, achieving significant results. **In March 2021**, the "Opinions on Further Deepening the Reform of Tax Collection and Administration" jointly issued by the General Office of CPC Central Committee and the General Office of State Council emphasized the need to "continuously deepen the pattern of tax co-governance" "strengthen inter-departmental cooperation and social synergy" and "enhance intelligence exchange, information sharing and law enforcement collaboration, and actively promote cross-departmental coordinated supervision", which provided a crucial guideline for inter-departmental collaboration. **In October 2021**, six government departments jointly (Supreme People's Procuratorate and State Administration of Foreign Exchange as new members) issued "the Guiding Opinions on Regularizing Crackdown on Fraudulent Invoicing and Tax Fraud", and set up national and regional leadership groups, which are responsible for organizing, coordinating, supervising, and evaluating the work of the joint crackdown on tax fraud. The general office of the leadership group is located in the tax authority. The main responsibilities of the leadership group are as follows: hold regular joint meetings to guide the work of combating tax fraud; carry out joint supervision of key cases and performance evaluation; issue regular circulars to commend departments and individuals with outstanding performance and to stimulate work motivation; provide joint training and strengthen case exchange seminars to improve case-handling capacity of staff. **In June 2023**, the leadership group expanded to incorporate the Supreme People's Court, facilitating the advancement of efforts to combat tax-related crimes in a comprehensive manner. Across different provinces, strengthened collaboration among seven departments has resulted in distinctive models of inter-departmental cooperation.

#### **●Practice in Shenzhen**

In recent years, the seven authorities in Shenzhen have established and kept improving the working mechanism of seven departments to systematize the fight against tax fraud. As a result, the intensity of efforts to combat tax fraud has continued to escalate and the synergy among different authorities has grown stronger.

(1) Collaborative analysis and determination to converge strengths for swift identification and early suppression. The seven authorities in Shenzhen have embarked on innovative initiatives such as the creation of the Smart Tax Inspection platform and the "Falcon" Innovative Laboratory to share intelligence, conduct joint assessments, and launch data-guided and intelligence-led investigations, thus allowing quicker and more accurate identification of lawbreakers involved in illegal activities. **Shenzhen Tax Service** has adopted a whole-process approach in export refund fraud prevention and control, high-risk enterprises are identified by analyzing trading relationships, tax declaration information, and personnel interactions. **Shenzhen Customs District** has put its focus on fake trade and fictitious exports. By fully utilizing the criminal investigation authority of its anti-smuggling unit and the availability of customs export data, Shenzhen Customs District has identified multiple leads involving smuggling and tax fraud and collaborated with tax and public security authorities to manage and solve these cases. **Shenzhen Branch of the People's Bank of China** and **Shenzhen Office of the State Administration of Foreign Exchange** have leveraged their financial oversight capabilities to identify clues involving false settlements for claiming rebates, money laundering and underground banking. This collaborative approach achieves a unified crackdown on export refund fraud, underground banking and money laundering, aligning the fight against various forms of tax-related illicit activities.

(2) Coordinated operations to enable multi-dimensional and joint crackdowns. The strategy of Shenzhen is uniting tax, public security, and customs authorities to deploy resources, coordinate investigations and actions. This strategy underpins the advantages of multi-departmental collaboration. In particular, giving full play to its leading role, **Shenzhen Police-Tax Joint Task Force** has vigorously facilitated the concrete functioning of a joint operations center that consolidates data from the seven authorities, including "invoice flow, fund flow, goods flow, and personnel flow." Harnessing technical tools, the Joint Task Force progressively delves deeper, tracing and identifying the entire chain of criminal syndicates. On discovering fraudulent invoicing, export refund fraud, and related illicit activities such as tax-related black intermediaries, illegal customs clearance agencies, underground banking and smuggling groups, the Joint Task Force will stage collaborative operations to collect all sorts of evidence and conduct interrogations of suspects. These actions can support the further procedures for both administrative cases and criminal litigation cases.

(3) Collaborative diagnosis to address challenges and punish criminals. In addressing the challenges of characterizing export refund fraud cases, **Shenzhen's procuratorates and courts** have, by proactively harnessing their advantages in legal oversight and judicial adjudication, established a "collaborative diagnosis" mechanism involving tax and public security authorities, procuratorates and courts. Aiming at seeing through the appearance to perceive the essence, this mechanism utilizing an evidence-based research approach, can

facilitate objective judgement and determination on the facts and conduct, thereby further standardizing evidence criteria and rules, strictly punishing those law breakers and criminals in accordance with law. If tax-related cases involve litigation, the relevant authorities will promptly respond to the **court's** queries and provide specialized reference materials before the trial, thus ensuring the clarity of evidence and the due process of law for the suspects.

(4) Enhancing co-governance to amplify impact and facilitate long-term regulation. In response to tax risks in specific sectors and industries, efforts are being made to achieve sustainable governance. Through case analysis, the **tax authority** has proposed over 80 improvement measures, leveraging investigative activities to stimulate regulatory and corrective actions. The **public security authority** has insisted on curbing illicit activities through stringent crackdowns and enhancing oversight over key targets such as shell companies and illicit intermediaries. The **procuratorial bodies** have formulated guidelines based on typical case studies, providing consistent judicial standards for handling cases. The **customs administration** has also introduced guidelines to enhance export tax management by boosting customs interception capabilities. The **People's Bank of China and the foreign exchange administration** have established monitoring models for suspicious fund transactions, thereby enhancing the effectiveness of financial oversight. Concurrently, a concerted effort is being made to amplify the public discourse, consistently increasing the exposure of exemplary cases. In total, 27 batches of cases have been exposed, achieving good social and legal effects and fostering a favorable public opinion climate.

#### **IV. Evaluation and Outcomes**

As the inter-departmental collaboration in Shenzhen develops, the efforts to combat export refund fraud have evolved from traditional solitary actions to large-scale coordinated operations. This transformation effectively safeguards the legitimate rights and interests of law-abiding taxpayers and fosters a more equitable and just business environment.

(1) Rampant fraudulent invoicing and tax fraud have been effectively curbed. Since 2022, with the concerted efforts of multiple departments, enforcement action has been taken against a total of 667 enterprises in Shenzhen for export refund fraud, leading to the recovery of tax losses and fines amounting to RMB 2.54 billion, effectively curbing the momentum of rampant fraudulent invoicing and tax fraud activities. The crackdown on syndicates cases has been significantly enhanced and the speed of investigation has been observably accelerated. In June 2023, 6 tax fraud cases were jointly cracked down, which has exceeded the total number in 2021.

(2) Compliance in key sectors has been stabilized and enhanced. Through targeted crackdowns, sectors with high risks of export refund fraud, such as textiles, wooden furniture, lithium batteries, software, agricultural products, and precious metals, have been meticulously regulated. This has led to a reversal of the grim situation of export refund fraud in related sectors, with a pronounced downward trend observed. For example, in 2022, the tax auditing bureaus of Shenzhen Tax Service found that tax fraud syndicates colluded with rampant fraudulent invoicing syndicates of inland provinces and cities, obtained invoices of

"woven cloth" products for tax fraud purposes. A wave of crackdowns and strengthened supervision have been immediately launched, which significantly curbed the trend. In 2021, tax fraud enterprises used this method to defraud tax refund of RMB 10.47 million, which was reduced to 2.47 million yuan in 2022, and no tax fraud of this type was detected in 2023.

(3) The regulatory framework integrating prevention and crackdown has been further strengthened. Upholding a synergy between prevention and crackdown, stringent control at the source has been continuously enhanced, a solid governance foundation has been laid, and oversight over key entities such as shell companies and illicit intermediaries has been intensified, thereby elevating China's governance capacity and the modernization of its governance system. It has realized the transformation from single strike to long-term strategies, lending robust support to the market-economic order and national tax security.

## **V. Limitations and Recommendations**

As inter-departmental collaboration continues to deepen, there has been a certain degree of containment in the trend of fraudulent invoicing and tax fraud. However, tax-related criminal cases persistently resurfaced. Due to factors such as data confidentiality, divergent focal points of work, and administrative-criminal disparities between departments, this collaborative model still has certain limitations and is in need of further consolidation and optimization.

(1) Crackdown efforts to be further strengthened. The authorities shall materialize concrete bases such as the Police-Tax Joint Operations Center and the Tax-Customs Collaborative Assessment Center. Enhanced inter-agency communication, joint analysis, coordinated enforcement, and talent development should be prioritized to foster specialized teams through practical training and to nurture skilled professionals. In harnessing the respective strengths of different authorities, we shall ensure smooth administrative-criminal coordination, standardize evidence criteria in tax-related cases, and issue relevant evidence rules and case references to guide frontline personnel in case handling. Additionally, we shall leverage investigative activities to stimulate regulatory and corrective actions, tailor recommendations for specific cases, conduct analogous case analyses, promote industry rectification, and implement thematic analyses to forestall industry-specific, systemic, and regional risks.

(2) Information sharing to be further deepened. We shall intensify information sharing among the seven authorities, constantly explore collaborations with other departments and enterprises, expand the scope of multidimensional big data pools to cover invoices, funds, logistics, imports and exports, foreign exchange, and freight forwarding, effectively aggregate regulatory information across governmental departments in a timely manner, and utilize cross-departmental, cross-regional, and cross-level data sharing to provide robust support for joint crackdowns. We shall enhance coordinated investigation and prosecution of fraudulent activities, including fraudulent invoicing, tax fraud, and associated offenses like subsidy fraud, smuggling, money laundering, and false transactions. We shall strengthen tracking and crackdown on the illegal cross-border circulation of criminal funds, promote

joint case management and investigation, and achieve comprehensive, integrated crackdowns along the entire chain.

(3) Greater importance to be attached to cross-border collaboration. As crackdown efforts on tax-related criminal activities intensify nationwide, criminals are resorting to cross-border physical separation to conceal their intentions. Against this backdrop, there's a need to shift focus overseas and staunchly curb criminal trends through cross-border cooperation. We should establish and refine multi-stakeholder special intelligence exchange mechanisms to promptly access taxpaying entities' financial flows abroad and join forces in combating tax-related criminal activities such as fraudulent invoicing perpetrated through cross-border means.



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