Tax Risk Prevention for Small and Medium-Sized Enterprises under Golden Tax Phase IV

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Abstract. In recent years, China has vigorously promoted electronic invoicing and the Golden Tax Phase IV project, advancing the construction of an intelligent tax system and improving the efficiency of tax supervision. At the same time, this has posed a series of challenges to enterprise tax management, especially for small and medium-sized enterprises (SMEs). Due to their relatively imperfect business systems, SMEs may encounter a range of issues under the stringent supervision imposed by Golden Tax Phase IV. Against this background, this paper primarily analyzes the various tax risks that SMEs may face under Golden Tax Phase IV, organizes the existing problems, and puts forward relevant recommendations.

Keywords: Golden Tax Project, Golden Tax Phase IV, Tax Risks, Small and Medium-Sized Enterprises, Risk Prevention

1. Introduction

With the deepening development of the digital economy, China's tax collection and administration system is undergoing significant transformation. The comprehensive promotion of electronic invoicing alongside the steady advancement of the Golden Tax Phase IV project marks a new stage in the construction of an intelligent tax system, laying a solid foundation for establishing a fair tax environment. However, for small and medium-sized enterprises (SMEs) whose business systems remain underdeveloped and whose compliance capabilities are relatively weak, the stringent regulatory framework of Golden Tax Phase IV presents immediate challenges and tests. Against this backdrop, accurately identifying such risks has become a critical issue for the sustainable development of SMEs. Accordingly, this paper analyzes the relevant problems encountered in the daily operational activities of SMEs.

2. New functional changes in Golden Tax Phase IV

Digital transformation is increasingly becoming the mainstream trend in tax administration. The Golden Tax Phase IV system, launched by the State Taxation Administration, exemplifies this development. As a significant upgrade to China's taxation system, Golden Tax Phase IV marks the ushering in of a new digital era in tax collection and management [1]. The main changes are as follows:

2.1. Coverage of non-tax business under Golden Tax Phase IV

Golden Tax Phase IV, building upon Phase III, has incorporated the management of non-tax revenues [2], thereby rendering tax supervision more comprehensive. Under this new system, enterprises are required to remit various non-tax items through the tax authorities, including social insurance fees, cultural undertakings construction fees, garbage disposal fees, water conservancy construction funds, and land use right transfer fees. This development not only expands the data collection channels available to tax authorities but also broadens the scope of their data acquisition, enabling tax departments to more accurately monitor and manage taxpayers' information.

2.2. Intelligent integration of tax and fee information under Golden Tax Phase IV

Golden Tax Phase IV incorporates advanced information technologies such as cloud computing, artificial intelligence, mobile internet, and big data. The application of these technologies aims to intelligently aggregate tax and fee information of enterprises and individuals by adopting a "single-entity" management system for legal persons and a "single-person" management system for natural persons. This approach enables automatic analysis and monitoring of information related to an enterprise or individual across different time periods, tax categories, and fee types. Moreover, it facilitates matching analyses of tax and fee conditions among enterprises or individuals of comparable scale and type. Consequently, the efficiency and accuracy of tax administration have been greatly enhanced, providing more robust data support for tax supervision.

2.3. Gradual realization of invoice digitization under Golden Tax Phase IV

The core objective of the Golden Tax Phase IV project is to promote the comprehensive digitalization of electronic invoices and to achieve the complete electronic and cloud-based transformation of enterprise financial processes. Compared to Golden Tax Phase III, Phase IV not only broadens supervision over non-tax businesses but also enhances integration with information from other regulatory agencies. In recent years, the project has successfully completed the tendering of its core system and has begun gradual rollout and implementation. This initiative marks a shift in tax administration effectiveness from reliance on paper invoice management to data-driven tax management. Simultaneously, it propels the tax sector's governmental systems from traditional informatization toward advanced digital transformation. This transformation is expected to significantly improve the efficiency and precision of tax administration.

2.4. Realization of multi-source information sharing under Golden Tax Phase IV

Golden Tax Phase IV has established a network platform for information sharing and verification that encompasses multiple departments, including various government ministries, the People's Bank of China, commercial banks, and at least 46 related institutions. The system's core functions include verifying mobile phone numbers of enterprise personnel, the tax status of enterprises, and the registration information of enterprises. The creation of this platform facilitates interdepartmental information sharing and verification, substantially enhancing information transparency and regulatory efficiency. Through this mechanism, the Golden Tax Phase IV project effectively promotes coordination among government agencies and enables the precise utilization of data, thereby providing robust support for tax and financial supervision.

2.5. Enhanced information verification functions under Golden Tax Phase IV

Building upon information sharing, Golden Tax Phase IV leverages big data technology to further improve the accuracy and efficiency of information verification by automatically comparing data from multiple sources to swiftly identify inconsistencies or anomalies. For instance, the system can comprehensively analyze enterprise declaration data alongside bank transaction records, customs import and export documentation, and social insurance payment records, cross-validating these datasets to effectively detect potential tax violations such as tax evasion, underreporting, or the use of fraudulent invoices to inflate expenses. This significantly enhances the precision and efficiency of tax audits and substantially curbs the occurrence of tax-related illegal activities. Consequently, under the influence of Golden Tax Phase IV, enterprises are confronted with elevated compliance demands and must strengthen their financial and tax knowledge while cultivating a robust awareness of tax risks to adapt to this new tax regulatory environment.

3. Tax-related characteristics of small and medium-sized enterprises

3.1. Weak tax awareness

Small and medium-sized enterprises (SMEs) often demonstrate weak tax awareness and insufficient attention to tax regulations during their business operations. These shortcomings may lead to tax omissions in filing and payment procedures, thereby increasing the risk of regulatory violations. Moreover, due to inadequate understanding of tax incentive policies, enterprises may fail to effectively leverage such policies to reduce their overall tax burden, adversely impacting economic efficiency. Additionally, tax violations resulting from poor tax awareness can damage the company's reputation and undermine trust relationships with customers and business partners.

3.2. Lack of a competent tax team

Small and medium-sized enterprises (SMEs) often face significant challenges in establishing professional tax teams due to constraints in scale and resources. This can result in gaps in tax planning, compliance audits, and tax filing processes. Without the guidance of a specialized tax team, enterprises may experience operational errors and heightened tax risks, which can lead to the inaccurate interpretation and application of tax laws and regulations.

3.3. Irregularity in daily business operations

Due to the lack of standardized procedures and operational norms in their daily business activities, small and medium-sized enterprises (SMEs) often face issues such as incomplete or inaccurate tax records. This can hinder the provision of clear and accurate financial information during tax declaration, thereby increasing the risk of tax audits. Furthermore, such irregular business practices may negatively impact the efficiency of internal management and decision-making, ultimately affecting the long-term development of the enterprise.

3.4. Frequent financial transactions

For most small and medium-sized enterprises (SMEs), frequent financial transactions are a common occurrence [3], which adds a certain degree of complexity to tax management. The high volume of transactions can make it difficult for enterprises to accurately track and document each transaction

during tax declaration, thereby posing challenges to tax compliance. Moreover, any lack of transparency or irregularities in financial dealings may attract the attention of tax authorities, increasing the risk of audits and inspections. Failure to properly manage related tax issues may result in penalties or even legal sanctions, thereby impacting the enterprise's financial health and reputation. Therefore, SMEs must ensure transparency and adherence to proper procedures in financial transactions to avoid tax-related complications that could adversely affect their operations.

3.5. Low level of information technology adoption

Small and medium-sized enterprises (SMEs) often invest limited resources in information technology infrastructure, relying instead on traditional manual operations and paper-based records. This not only reduces operational efficiency but also increases the risk of errors, making it difficult for enterprises to achieve automation and digitalization in tax management. Insufficient IT capability also hampers enterprises in areas such as tax data analysis, risk warning systems, and decision-making support. Consequently, they may struggle to respond promptly to changes in tax policies, thereby undermining their tax compliance and limiting opportunities for tax optimization.

4. Tax risk factors for small and medium-sized enterprises under the Golden Tax Phase IV

4.1. Capital transaction risks

Under the Golden Tax Phase IV system, frequent capital transactions conducted by small and medium-sized enterprises will attract the attention of tax authorities. This system is capable of using big data and artificial intelligence technologies to monitor enterprise cash flows in real time, so any abnormal or non-compliant financial transaction may raise red flags. If a company's capital flow does not align with the scale and nature of its business, tax authorities may suspect tax evasion. If the company's cash flow does not match its declared income, the authorities may further investigate whether the enterprise is concealing revenue. In addition, if frequent capital transactions involving value-added tax are not properly handled for tax credit purposes, this may also lead to inaccuracies in tax filings.

4.2. Risk of receiving fraudulent invoices

Due to the lack of a competent tax team, small and medium-sized enterprises (SMEs) may have difficulty distinguishing genuine invoices from fraudulent ones, leading to the risk of obtaining invoices that have been fraudulently issued by others. During the course of their operations, SMEs may inadvertently acquire such fraudulent invoices and thus face a series of tax-related risks. According to the Interim Regulations of the People's Republic of China on Value-Added Tax and the Administrative Measures of the People's Republic of China on Invoices, the use of fraudulent invoices for tax deduction is strictly prohibited. Once such behavior is detected by the tax authorities, the enterprise will not only be disallowed from deducting the input tax but will also be required to reverse any previously deducted tax amounts. Under the regulatory framework of the Golden Tax Phase IV system, the tax authorities can more accurately identify and crack down on fraudulent invoice practices through the use of big data and information technology. Even if the enterprise is identified as a victim of fraudulent invoicing, it may still attract scrutiny and penalties from tax authorities due to poor management or inadequate invoice verification, regardless of its lack of intent.

4.3. Risks of concealing and changing the nature of income

Due to insufficient understanding of tax laws or improper practices, small and medium-sized enterprises (SMEs) may attempt to reduce their tax burden by concealing income or altering the nature of income; however, these actions carry significant tax risks. For example, enterprises may hide income by receiving payments without issuing invoices or by using personal accounts to conceal earnings, thereby achieving tax evasion. Under the strict supervision of the Golden Tax Phase IV system, such practices can be detected by tax authorities through data analysis and tracing of fund flows. The system can also trigger further investigations by comparing undeclared income with invoiced amounts and actual business activities, potentially resulting in the enterprise being liable for back taxes, late payment penalties, and fines. Furthermore, if an enterprise attempts to evade withholding and payment obligations for individual income tax by fabricating transactions or altering income nature, it may not only be subject to heavy fines but also risk criminal charges for tax evasion.

4.4. Risks of discrepancies between accounts and actual situations

If small and medium-sized enterprises (SMEs) experience discrepancies between their accounting records and actual conditions during operations, they will face significant tax risks. Issues such as unrecorded income, falsely inflated costs and expenses, or inaccurate asset and liability records frequently lead to deviations between declared taxes and actual tax liabilities. Under the regulatory framework of the Golden Tax Phase IV system, tax authorities efficiently identify such discrepancies through big data analysis, real-time cross-departmental monitoring, and information sharing. If discrepancies are confirmed, enterprises will not only be required to make tax arrears payments and pay late fees but may also be subject to administrative tax penalties or even criminal prosecution.

4.5. Tax compliance risks related to shareholder loans

Improper handling of financial transactions between small and medium-sized enterprises (SMEs) and their shareholders can also lead to tax risks. For example, if a shareholder borrows funds from the company and fails to repay them by the end of the tax year, and the funds are not used for business operations, according to the Notice of the Ministry of Finance and the State Administration of Taxation on Regulating the Collection and Administration of Individual Income Tax from Individual Investors (Cai Shui [2003] No. 158), the outstanding loan will be regarded as a dividend distribution from the enterprise to the individual investor, subject to individual income tax under the category of "interest, dividends, and bonuses." If the shareholder loan remains unpaid for more than one year, a 20% individual income tax is payable. Additionally, if the company provides interest-free loans to shareholders, according to Article 41 of the Corporate Income Tax Law, if such loans do not comply with the arm's length principle, tax authorities have the right to make tax adjustments and require the company to pay the corresponding taxes. Likewise, under Article 8 of the Individual Income Tax Law, if an individual shareholder's interest-free loan from the company does not meet the arm's length principle, tax adjustments may also be imposed. Against the backdrop of Golden Tax Phase IV, tax authorities' regulatory capabilities have been further enhanced, enabling more effective monitoring and analysis of enterprise financial data, including capital transactions. The big data and artificial intelligence technologies of Golden Tax Phase IV assist tax authorities in identifying abnormal cash flows, thereby improving the efficiency of detecting behaviors such as income concealment and alteration of income nature.

5. Prevention of tax risks for small and medium-sized enterprises under the Golden Tax Phase IV

5.1. Strengthening internal control and technical support

Under the comprehensive monitoring of the Golden Tax Phase IV system, small and medium-sized enterprises (SMEs) should enhance their awareness of tax compliance and ensure that all capital transactions are lawful and compliant. Enterprises need to improve internal financial management systems [4], strictly monitor cash flows, and conduct regular tax self-inspections to promptly identify and rectify potential issues. They can also utilize the electronic invoicing system provided by Golden Tax Phase IV to improve the accuracy and efficiency of tax management. At the same time, enterprises should proactively communicate with tax authorities to stay updated on the latest tax policy developments and ensure the accuracy of tax declarations. Furthermore, regular tax knowledge training for employees is necessary to enhance operational standardization and reduce tax risks. For complex tax matters, enterprises may also hire professional tax consultants or tax agents to obtain expert tax planning and risk assessment services, thereby ensuring stable business operations.

5.2. Strengthening internal monitoring of invoice management and compliance training

Enterprises should implement a series of measures to prevent the risk of obtaining fraudulent invoices and ensure tax compliance. First, companies need to strengthen internal controls to ensure that the processes for acquiring, reviewing, and using invoices are rigorous, thereby avoiding the receipt of fraudulent invoices. Second, suppliers should be subject to strict vetting to ensure that the invoices they provide are legitimate and valid. Additionally, enterprises should regularly conduct training for finance and procurement personnel on tax regulations and compliance procedures [5], enhancing their awareness of the risks related to fraudulent invoices and their ability to prevent such risks. The use of electronic invoicing systems can also improve the efficiency and accuracy of tax management, reducing human error.

5.3. Establishing a sound internal financial management system

To prevent tax risks arising from SMEs' concealment or alteration of income nature due to insufficient understanding or improper application of tax laws, enterprises should implement a series of preventive measures. First, efforts should be intensified in tax law education and training to ensure that management and financial personnel have an accurate understanding of tax laws and apply them appropriately. Second, internal control systems should be improved to ensure that all income and expenses are fully recorded and correspond to actual circumstances. At the same time, invoice management should be standardized, with invoices issued and obtained in accordance with regulations. Additionally, to enhance financial transparency and avoid conducting business through informal channels such as personal accounts, enterprises should ensure that their accounts truthfully and accurately reflect their financial status. Through these measures, enterprises can reduce tax risks caused by inadequate tax law awareness in tax management.

Enterprises should also regularly conduct internal audits of tax declarations, financial records, and related work to promptly identify and correct potential tax risks. They should establish a tax risk early warning mechanism, utilizing financial software and tax management tools to monitor abnormal cash flows and irregular tax filings in a timely manner. For issues discovered during

inspections, enterprises should actively cooperate with tax authorities by providing necessary documentation and promptly carrying out rectifications. Additionally, enterprises need to raise legal awareness among all employees, ensuring a clear understanding of the legal consequences of tax evasion, so as to avoid serious legal problems caused by temporary errors in tax operations.

5.4. Strengthening financial compliance management and internal control auditing

Improving the internal financial management system is a necessary measure for enterprises to prevent tax risks. Enterprises are required to ensure timely and accurate handling of accounting by financial personnel; strengthen communication with tax authorities to stay informed of changes in tax policies and regulatory requirements; fully utilize real-time monitoring and automated processing capabilities of financial software and information management systems; regularly engage professional institutions to inspect and verify accounting records. Finally, enterprises should enhance business training for financial staff to raise their awareness of legal compliance, ensuring that accounting practices conform to legal regulations. This helps effectively avoid tax risks caused by discrepancies between accounts and actual conditions. Enterprises must prioritize tax risk prevention, provide regular business training for financial personnel, and ensure accounting practices are properly regulated and traceable.

5.5. Standardizing compliance operations for shareholder loans and fund management

To prevent tax risks arising from capital transactions between small and medium-sized enterprises (SMEs) and their shareholders, enterprises should first strictly regulate these transactions, avoiding situations where shareholder loans are not repaid promptly. When necessary, written contracts should specify the loan purpose and term to ensure that funds are used for business operations. Secondly, enterprises should establish sound financial approval and fund management systems to strictly review and manage shareholder loans, preventing interest-free loans or loans that do not comply with the arm's length principle. Enterprises should also conduct regular internal audits of capital transactions with shareholders, promptly addressing any abnormalities to ensure compliance with tax regulations.

6. Conclusion

In summary, the implementation of the Golden Tax Phase IV system has not only promoted the intelligent upgrading of tax collection and administration but also imposed higher requirements on tax compliance for small and medium-sized enterprises (SMEs). Due to issues such as low levels of information technology adoption and insufficient professional capabilities, SMEs face risks including irregular invoice acquisition and discrepancies between accounts and actual conditions. To address these problems, enterprises need to strengthen internal controls and technical support, enhance compliance management, and implement other risk prevention measures. These efforts will help enterprises solidify their foundations for development and achieve sustainable growth.

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