

Unlocking a Mystery of China Compliance: *Fapiao*s

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Anyone who has spent time dealing with compliance issues in China has encountered *fapiao*s (发票). This advisory will explain (1) what a *fapiao* is, (2) the different types of *fapiao*s and receipts in China, (3) how *fapiao*s can be misused for fraud, embezzlement, and corruption, and (4) ways to counter these schemes to minimize compliance risk.

Fapiao 101

So what is a *fapiao*? In essence, a *fapiao* is a paper receipt, recognized by Chinese tax authorities, that is provided by the recipient of a payment to show that the transaction actually occurred.

*Fapiao*s are normally generated for most business-to-business transactions as part of the internal payment process. But for business-to-consumer transactions (e.g., an employee stays at a hotel, an employee has a meal at a restaurant), *fapiao*s typically are not automatically generated, and a consumer must specifically request a *fapiao*.



Machine-printed *fapiao* (restaurant)

An employee would normally obtain a *fapiao* for all business expenses, including meals, hotel room fees, air tickets, etc. The *fapiao* is then used by the company in order to legally claim a tax deduction for business expenses. If the company did not want to seek a tax deduction for a particular expense, it would not be necessary to obtain a *fapiao*. But nearly every company operating in China -- multinationals and Chinese companies alike -- requires those seeking reimbursement from the company (employees and third-party service providers alike) to obtain a *fapiao* for any expense and then submit it for reimbursement.

In addition to being proof of a tax-deductible transaction for the payor, a *fapiao* is proof of the transaction for tax liability for the payee (i.e., the company receiving the money). If a recipient of a payment does not issue a *fapiao*, it is much harder for the Tax Bureau to prove that they actually received taxable income. For this reason, a number of businesses will resist issuing a *fapiao*. In some cases, a reason given for not issuing a *fapiao* may or may not be legitimate, such as the

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fapiao machine is broken, or the business has run out of *fapiao* paper. In some cases, an establishment will issue a *fapiao* but will insist that a consumer pay the incremental income tax (perhaps 5-6%) that the business would otherwise evade on the expense.

Importantly, a *fapiao* can be issued only by a legally registered business entity in China assigned a tax identification number; an individual cannot issue a *fapiao* by himself or herself. Similarly, many mom-and-pop stores are not properly licensed to provide *fapiao*s. Both individuals and small stores can visit the local Tax Bureau to submit certain documents and have the Bureau issue a *fapiao*. For both the tax implications and the hassle, many resist issuing a *fapiao*.

When a government agency in China receives a fee for an official service, it will issue a type of official receipt to the payor titled “receipt of fees for administrative activities” (行政事业性收费票据) rather than a *fapiao*.

Different Types of *Fapiao*s

With the exception of small businesses in small cities, most businesses have cash registers and can issue a point-of-sale receipt (收据 or 小票) that would look familiar to someone outside of China. This is not a *fapiao*. Similarly, when a credit or debit card is used in China (either an international credit card or a local UnionPay-linked credit card), the consumer usually receives a receipt. This is also not a *fapiao*.

As noted in above, a *fapiao* usually must be requested for business-to-consumer transactions.

*Fapiao*s come in different varieties. Knowing what type of vendors generally provide what type of *fapiao*s can minimize the risk of fraud or corruption.

A **machine-printed *fapiao*** (机打发票) is printed on a small machine using special paper issued by the local Tax Bureau.

Most establishments will ask if you want a “individual” or “company” *fapiao*. Both are legitimate. An individual (个人) *fapiao* will list “individual” (个人) or the recipient’s name in English or Chinese (e.g., “Eric Carlson” or “柯礼晟”), whereas a company (单位) *fapiao* will list the company’s Chinese name.

The *fapiao* will contain the date, a brief description of the expense in Chinese (e.g., “meal fee,” “room fee,” “service fee,” “consulting fee”), the date, the name of the establishment issuing the *fapiao*, and a set of codes used for verification.

Many establishments require a consumer either to trade the point-of-sale receipt for the *fapiao*, or to stamp the point-of-sale receipt with a notation that the “*fapiao* has already been issued” (发票已开). This requirement prevents customers from asking for a second *fapiao* for the same expense.



Machine-printed *fapiao* (taxi)

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Most *fapiao*s for significant business-to-business transactions (i.e., where payment would be made via bank transfer rather than cash) are machine printed these days. *Fapiao*s in business-to-business transactions often are not presented precisely at the time of payment. It may be submitted prior to payment, or mailed after payment, so the date on the *fapiao* may not necessarily match the date of payment.

A machine-printed *fapiao* should have a red *fapiao* “chop” (or “seal” 发票专用章) of the establishment stamped on the *fapiao*. The red “chop” includes the name of the establishment issuing the *fapiao* and its tax identification number (纳税人识别号).

Taxis are a special case. In China, taxis in almost all major cities have a machine that prints a *fapiao* that shows the date, time, distance, and total cost of the travel. These *fapiao*s are printed in the taxi when the taxi stops the meter, and do not include the name of the recipient. (Travel alert: some taxi drivers will say that their meter is “broken,” either to negotiate a higher fare than what the consumer would otherwise pay, or to avoid a record of the transaction to minimize tax liability.)

Fixed-value *fapiao*s (定额发票) are commonly used in fast-food restaurants, toll booths, gas stations, some smaller restaurants, cabs in smaller cities, subways, busses, and other high-volume repeat-transaction establishments. They are smaller, square or rectangular pieces of paper that list certain denominations on each one (e.g., RMB 1, RMB 5, RMB 10, RMB 50), not unlike Monopoly money. Fixed-value *fapiao*s are printed by the local Tax Bureau, but like machine-printed *fapiao*s, the name of establishment and its tax identification number should be visible in the red “chop” stamped on the face of the *fapiao*.



Fixed-value *fapiao*

Some establishments are careful to provide fixed-fee *fapiao*s in the exact amount of the purchase -- for a purchase of RMB 48, they would give you two 20s, a 5, and three 1s. Other establishments simply “round up” -- for an expense of RMB 48, they would give you one *fapiao* of 50.

Handwritten *fapiao*s (手工发票). As the name implies, these are handwritten by the proprietor of a business, often a small restaurant or small store. These are mostly found in smaller cities and are gradually becoming less common. A handwritten *fapiao* should also include the red *fapiao* chop of the establishment.



Handwritten *fapiao*

How *Fapiao*s Can Be Misused

Because *fapiao*s are ubiquitous in the Chinese business landscape, there are various schemes for misusing *fapiao*s.

Inflated *fapiao*s. Some establishments will issue an authentic *fapiao* but in an amount greater than the actual expense. A portion of the difference will be kicked back to the establishment to cover the tax on the difference, and/or to an individual at the establishment who issued the *fapiao*. For instance, an employee may have a business-related meal at a restaurant with a client, and the waiter delivers a bill of RMB 400. The company employee discusses and agrees with the waiter (or restaurant owner) to create a *fapiao* for RMB 600. The company employee pays the restaurant the RMB 400, plus perhaps RMB 50 to the restaurant to cover the incremental tax. The employee seeks reimbursement for RMB 600 using the inflated *fapiao*, even though he only spent RMB 400. The remaining RMB 150 could be pocketed by the company employee, shared with the client, or used to fund a bribe. This was common several years ago with travel agencies (see my June 2013 post [here](#)), which was posted a month prior to media scrutiny of the practice starting in July 2013.

Fake *fapiao*s. Anyone who speaks or reads Chinese and lives in China knows the legions of advertisements for fake *fapiao*s. Ads can be found on business cards stuck in elevators and subway cars. Spray-paint *fapiao* offers are stenciled onto walls. Owners of Chinese mobile phones routinely receive SMS/text messages advertising fake *fapiao*s. (The civil and criminal penalties for making, issuing, selling, and purchasing fake *fapiao*s seem to have a limited deterrent effect.) Fake *fapiao*s look real but cannot be verified through the local tax bureau, although some advertisements for *fapiao*s assert that they can in fact be verified.

In this scheme, an unscrupulous employee purchases a book of these fake *fapiao*s for a low price -- for instance, RMB 100. The face value of the fake *fapiao*s is much higher -- perhaps RMB 2000. The unscrupulous employee submits these fake *fapiao*s to the company for reimbursement. If the employee is able to get away with it, he has made a tidy profit of RMB 1900, which can be pocketed or used for an improper payment.

Borrowed *fapiao* machines. Establishments (often a restaurant) sometimes “rent out” their *fapiao* machines to a third party, who then print fictitious *fapiao*s and pays a fee to the restaurant for use of the machine. The third party sell *fapiao*s to unscrupulous employees, which seek reimbursement from the company similar to the scenario above.

In this scenario, no transaction actually occurs, but because the *fapiao* was printed from a legitimate *fapiao* machine, the *fapiao* can be verified with the local tax bureau, which makes detection more difficult.

A variation of this scenario is the “cloned” *fapiao*, which a duplicate *fapiao* is printed from a legitimate machine containing the same transaction details, such as date, time, and amount. In this variation, an employee obtains a duplicate *fapiao* and then submits two *fapiao*s at different times and is reimbursed twice for the same expenses. (Alternatively, the employee shares the duplicate with a co-worker/friend, who seeks reimbursement as well.) Because both the original and the duplicate *fapiao*s were printed from a legitimate machine, the *fapiao* can be verified with the local tax bureau.

“Substitute” *fapiao*s (替代发票). Another common scheme is for an employee to seek reimbursement for a personal expense that is not work-related expense (for example, a meal

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with one's family or friends, or gas for a personal car). In this scenario, the employee claims in the expense report that she had dinner with a customer when in fact she had dinner with her family. A transaction actually occurred and the *fapiao* is "real" and verifiable, but the transaction was not as the employee described.

Fapiaos with incorrect descriptions. Many stores ask consumers how they want the description listed on the *fapiao*. Unscrupulous employees could ask for the expense to be listed as something innocuous when it was in fact gifts or gift cards. Descriptions such as "office supplies" (办公用品), "stationery" (文具), and "daily use items" (日用品) are commonly used in this scenario.

Real *fapiaos*. As the name suggests, the transaction occurs exactly as the employee describes.

The following table attempts to outline these different schemes.

	Fake <i>fapiao</i>	Borrowed <i>fapiao</i> machine	Substitute <i>fapiao</i>	Inflated <i>fapiao</i>	<i>Fapiao</i> with incorrect description	Real <i>fapiao</i>
An actual transaction at an establishment occurred?	no	no	yes	yes	yes	yes
Transaction occurred as employee described?	no	no	no	yes	no	yes
Transaction occurred in amount employee describes?	no	no	yes	no	yes	yes
Document can be verified by Tax Bureau?	no	yes	yes	yes	yes	yes

Risk Prevention

We suggest below potential ways to mitigate *fapiao*-related compliance risk.

Require third parties to submit individual *fapiaos* for their own expenses. Third parties engaged by a company (e.g., a conference organizer, travel agency, consultant) sometimes need to incur expenses in connection with the services they provided. Third parties submit a single, combined *fapiao* that includes these expenses in addition to whatever service fee the third party charges for their time or effort. From a compliance perspective, you can reasonably require that the third party submit supporting *fapiaos* for each separate expense that the third party incurred. Some of our clients require this and it is a good practice.

Verifying *fapiaos*. The Tax Bureau of every major jurisdiction in China has a website where a user can go online and verify that a *fapiao* is real. The information provided by the website can differ slightly for each jurisdiction. In most cases, the website will require the following numbers found on the face of the *fapiao*: (1) the *fapiao* code (发票代码) for the establishment issuing the *fapiao* (similar to a tax ID number); (2) the *fapiao* number (发票号码) (i.e., the unique number for the individual piece of paper); and (3) the password (密码) or verification code (验证码), which in some cities requires scratching off a gray box similar to a lottery ticket. (Scratching off the gray box exposes the verification code or password that is then used on the website.)

The government website will then indicate whether the information the user inputted is consistent with the Tax Bureau's records of *fapiaos* that it collected back from establishments. This verification will catch fake *fapiaos* but typically will not catch the other schemes. The website sometimes issues "false negative" results (i.e., saying that the information the user inputted is inconsistent with the Tax Bureau's records) because of data entry or technical errors with the Tax Bureau, but it at least suggests a red flag. There are other province-specific issues in using the Tax Bureau websites. (A list of websites for various provinces and major cities can be found by emailing the author at ecarlson@cov.com.)

Fapiaos can also be verified via a phone hotline and in-person at the relevant Tax Bureau. A few types of *fapiaos*, such as taxis, must be checked via telephone rather than online. Note that the data on the *fapiaos*, all of the websites, and the Tax Bureau hotline are in Chinese only.

In addition to routine review of expense reports by Finance, some of our clients sample a certain percentage of expenses each month or each quarter to look for *fapiao* fraud. Some clients look at an absolute number, some at a percentage of all expenses, and some at frequency (e.g., all employees will have at least one expense reviewed per quarter, all vendors will have at least one transaction checked per year). In our experience, employees who know that their expense reports may be checked are deterred somewhat from the more egregious forms of *fapiao* fraud.

Testing all *fapiaos* can be prohibitively time-consuming, but in our experience, sampling based on certain vendors, certain amounts, or in connection with other risk factors can be well worth the compliance investment.

Requirements to submit point-of-sale receipts and/or credit card slips. Some of our clients require the point-of-sale receipt to be submitted in addition to the *fapiao* where possible. (As noted above, some establishments require handing over the point-of-sale receipt to obtain the *fapiao*.) If the date, time, amount, vendor name, or other particulars of the three forms of documents are inconsistent, it could point to a misused *fapiao* scenario. Some of our clients require expenses over a certain amount to be paid using company or individual credit card, and

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require the credit card receipt to be submitted along with the *fapiao*. We regard these as good practices. These methods prevent fake *fapiaos*, borrowed machine *fapiaos*, and often *fapiaos* with incorrect descriptions, although they usually will not catch the other types of schemes.

Employee training. Some of our clients provide basic training on spotting irregularities in *fapiaos* to their finance personnel who review and process expenses. Others train external-facing employees on how to handle difficult situations, such as where the vendor says that the *fapiao* machine is broken, or the employee is presented with what may be a fake *fapiao*. Companies usually do not want to educate their employees on how to cheat the system, but training on company expectations can prevent situations where otherwise well-meaning employees cannot obtain a real *fapiao* for the business-related transaction and therefore use a substitute *fapiao* from a personal expense so they are not forced to pay for the business expense out of their own pocket.

Statement of services. As noted earlier, the descriptions of goods or services on a business-to-consumer *fapiao* usually are very short (e.g., “meal fee,” “room fee,” “service fee,” “consulting fee”). For business-to-business transactions, however, most companies require a contract or additional statement of services to pay services fees, consulting fees, agent fees, and the like. This is particularly useful when the payee is an individual.

Other compliance measures. Other techniques that some of our clients use include calls or site visits to establishments to confirm the legitimacy of expenses, and establishing black lists or white lists for certain establishments.

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This article first appeared as a four-part series on the FCPA Blog. To view the original posts, follow these links: [Part I](#), [Part II](#), [Part III](#), [Part IV](#). [Eric Carlson](#), a contributing editor of the FCPA Blog, is a partner at Covington & Burling LLP. He specializes in anti-corruption compliance and internal investigations, with a particular focus on China and other regions of Asia. He speaks Mandarin and Cantonese and can be contacted [here](#).

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