E-commerce Taxation in China

Rifat Azam

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** Assistant Professor, Radzyner School of Law, Interdisciplinary Center (IDC) Herzliya. Please contact me at razam@idc.ac.il.
I. Introduction

On August, 15, 2012 Bloomberg Business Week reported that the Chinese government approved the transaction in which Wal-Mart Stores bought a majority stake in Yihaodian, a Shanghai company that is a leader in the country’s booming online retail industry\(^1\). This transaction reflects the growing worldwide interest on the hot market of e-commerce in China. E-commerce market in China grow very fast in recent years with about 50% growth in the years 2008-2010 and around 20% of growth in 2011\(^2\) to reach more than 194 Million shoppers on line. The value of online shopping transactions in China jumped 51.6 percent year on year, to 268.4 billion Yuan, in the second quarter of 2012. According to one study, China holds the most e-commerce potential among emerging markets\(^3\). In its E-commerce 12\(^{th}\) Five Year Plan (2011-2015) released early this year (2012), China’s Ministry of Industry and Information technology announced plans to grow the value of e-commerce to 18 trillion Yuan in 2015\(^4\). This huge e-commerce market presents a challenge and opportunity to the Chinese consumers, Businesses, Government and State Administration of Taxation (SAT).

The Chinese tax system had known substantial changes in recent years to become more modern and international\(^5\). The Chinese Enterprise Income Tax (EIT), which is our main focus in this article, is levied on the worldwide income of any Chinese enterprise that is incorporated or managed in China. It also applies to any income attributable to an Establishment\(^*\) or Site\(^*\) of a foreign enterprises in China or any income sourced in China according to the Chinese source rule. The establishment rule and the other source rules are defined in similar manner as comparable concepts in the international tax system in territorial and physical terms. As a result, it is not surprising that these concepts face several challenges in the era of e-commerce that destroys territorial and physical concepts.

\(^1\) [http://www.businessweek.com/articles/2012-08-15/wal-mart-moves-into-chinas-hot-e-commerce-sector](http://www.businessweek.com/articles/2012-08-15/wal-mart-moves-into-chinas-hot-e-commerce-sector)
\(^2\) [http://www.apira.org/data/upload/The29thStatisticalReportonInternetDevelopmentinChina_hbwnp5.pdf](http://www.apira.org/data/upload/The29thStatisticalReportonInternetDevelopmentinChina_hbwnp5.pdf)
So far, China didn’t give a comprehensive response to the challenges of taxing e-commerce income. China started by applying the existing tax rules on income and value added to e-commerce but a lot of potential tax revenues were lost in this approach. Gradually, China is introducing special tax norms on e-commerce to close the gap. For example, online stores were required to register and disclose their actual ID to enable supervision and taxation of e-commerce by the governmental authorities\(^6\). In addition, new guidelines and regulations were introduced to enable and advance e-voicing as another infrastructure for taxing e-commerce. These and other changes promise an interesting discussion on e-commerce taxation in this article with expectations for new changes and crystallization of the law in china with special influence from the worldwide experience.

Following this introduction, chapter II will present the data on E-commerce in China. In section III we will describe the Chinese tax system in brief. The challenges of E-commerce taxation were be discussed in chapter IV. In chapters V and VI we will discuss the Chinese and Worldwide responses to the challenges respectively. We will end this article by a conclusion.

II. E-commerce in China

According to the 29th Statistical Report on Internet Development in China\(^7\), The number of Internet users in China is growing rapidly to 513 Million Users as of December 2011 to reflect an increase of about 56 Million users in comparison to 2009. Internet Users grow by 4% in 2011 to constitute 38.3% of the population in the end of 2011. There are 356 million mobile phone internet users in China with an increase of 5,285 ten thousand compared with that at the end of 2010. The proportion of the mobile phone internet users has covered 69.3% of the total internet users. Home computer broadband internet users reached 392 million, covering 98.9% of the home computer internet users. Internet users at the age of 30-39 increased remarkably, up 2.3% compared with those at the end of 2010, to 25.7%. In 2011, average duration for net citizens to surf internet is 18.7 hours per week with an increase of 0.4 hour compared with that at the end of 2010.

The 29th Report reveals that, as of the end of December 2011, the online shoppers reached to 194 million. The network shopping utilization rate is up to 37.8%. Compared with those in 2010, online

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\(^7\) [http://www.apira.org/data/upload/The29thStatisticalReportonInternetDevelopmentinChina_hbwnp5.pdf](http://www.apira.org/data/upload/The29thStatisticalReportonInternetDevelopmentinChina_hbwnp5.pdf)
shoppers increase by 33.44 million, a growth rate 20.8%. By the end of December, 2011, the number of group buying user is up to 64.65 million, and utilization rate to 12.6%, increasing 8.5% compared with those at the end of 2010. Annual growth rate of group buyer is as high as 244.8%. It has become the network services increasing the fastest at the second place in a year. By the end of December, 2011, users using online payment reached to 167 million, and utilization rate up to 32.5%. Compared with that in 2010, users increase by 29.57 million, the growth rate of 21.6%. By the end of December, 2011, our country’s travel booking users are up to 42.07 million, annual growth ratio 16.5%, and user permeability enhanced to 8.2%. Internet users will use travel booking service in a deeper way.

The 29th report brought a special discussion on e-commerce in china which gives us a lot of insight and knowledge. I will summarize here the main findings of the special discussion. In 2011, E-commerce grow by 20.8% while in 2008-2010 it grow by 50% annually for three consecutive years as appears in the following figure:

![Graph showing number, growth rate and penetration of online shopper during Dec. 2007 - Dec. 2011 in China](image)

**Fig. 39** Number, growth rate and penetration of online shopper during Dec. 2007 - Dec. 2011 in China

What are the reasons behind this slowdown in growth and what shall this data tell about the future of e-commerce in China? According to the special discussion in the 29th report, "decrease of total amount of new internet users and transmission fatigue of old internet users are the main cause of slowdown for online shopper growth"\(^8\). I am not sure that these are really the main reasons. To my

\(^8\) Supra, at p. 54.
understanding, the years 2008-2010 witnessed abnormal growth rate of 50% because e-commerce was in its early stages of development but in 2011 it became mature enough to start growing normally and more slowly. It is like a child who grows very fast in the first years of life and more slowly later on.

The report concludes that “there is huge growth space for online shopper and market in China in the future”9. This is because the Chinese e-commerce penetration rate is low in comparison to developed countries as shown by the following figure:

Data for China from CNNIC, data for the U.S. from PEW

Figure 42 Proportion of online shopper of different ages in China and United States

This figure means that e-commerce in China is far from peak and leaves a space for considerable and last growth in the future. But this growth depends on the development of delivery facilities, online security, and change in consumption behavior especially in old ages and rural areas and other factors. But, at the end of the day: “Viewed from anticipation of future development, the momentum of gradual deepened Internet penetration in China is irreversible. Supply and demand side of online shopping continues to be active, which will promote online shopping to grow steadily in the future for a long time. Though Chinese Internet penetration rate has slowed, penetration power remains strong. The popularity of low Internet level is accelerated for conversion. Along with enhancement of our residents’ income and purchasing power, internet users’ online consumption potential will continue to release. The momentum of development of electric commercial enterprises is strong. Online shopping supply capacity gradually grows.

9 Supra, at p. 55.
Service level continues to deepen. Those factors will effectively create room for further growth, and promote online shopping to grow steadily in the future for a long time”\textsuperscript{10}.

The statistics from iResearch show that in Q1 2012 China E-commerce revenue reached 1.76 trillion Yuan, a growth of 25.8% in comparable to the same period last year. The following graph\textsuperscript{11} reveals the structure of the market in Q1 2012:

![China E-commerce Market Structure in Q1 2012](image)

III. The Chinese Income Tax System in Brief

China like other countries levies several types of taxes to achieve several goals\textsuperscript{12}. It has direct, indirect and other taxes that are collected through central and local governments while along the years the share of the central government increased from 15.5% in the year 1978 to 51.1% in the year 2010 and the share of the local governments decrease from 84.5% in the year 1978 to 48.9% in the year 2010\textsuperscript{13}. The main taxes are domestic Vat which yield 28.81% of the total formal taxes in 2010; Corporate Income Tax with

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\textsuperscript{10} Supra, at p. 57.
\textsuperscript{11} \url{http://www.iresearchchina.com/views/4158.html}
\textsuperscript{12} See: Bin Yang, Eva Huang, Characterestics of the Chinese Tax System and its Cultural Underpinings: A Comparison With the West, 1 Journal of Chinese Tax & Policy (2011);
17.54% share; Individual Income Tax with 6.6% share. The following table\textsuperscript{14} reflects the amounts collected through taxes in China during the year 2010.

<table>
<thead>
<tr>
<th>Item</th>
<th>National Revenue</th>
<th>Government Revenue</th>
<th>Central Government</th>
<th>Local Government</th>
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<tr>
<td>National Government Revenue</td>
<td>83101.51</td>
<td>42488.47</td>
<td>40613.04</td>
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<tr>
<td>Total Tax Revenue</td>
<td>73210.79</td>
<td>40509.30</td>
<td>32701.49</td>
<td></td>
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<tr>
<td>Domestic Value Added Tax</td>
<td>21093.48</td>
<td>15897.21</td>
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<tr>
<td>Domestic Consumption Tax</td>
<td>6071.55</td>
<td>6071.55</td>
<td></td>
<td></td>
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<tr>
<td>VAT and Consumption Tax from Imports</td>
<td>10490.64</td>
<td></td>
<td>10490.64</td>
<td></td>
</tr>
<tr>
<td>VAT and Consumption Tax Rebate for Exports</td>
<td>-7327.31</td>
<td></td>
<td>-7327.31</td>
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<tr>
<td>Business Tax</td>
<td>11157.91</td>
<td>153.34</td>
<td>11004.57</td>
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<tr>
<td>Corporate Income Tax</td>
<td>12843.54</td>
<td>7795.17</td>
<td>5048.37</td>
<td></td>
</tr>
<tr>
<td>Individual Income Tax</td>
<td>4837.27</td>
<td>2902.97</td>
<td>1934.30</td>
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<tr>
<td>Resource Tax</td>
<td>417.57</td>
<td></td>
<td>417.57</td>
<td></td>
</tr>
<tr>
<td>City Maintenance and Construction Tax</td>
<td>1887.11</td>
<td>150.84</td>
<td>1736.27</td>
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<tr>
<td>House Property Tax</td>
<td>894.07</td>
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<td>894.07</td>
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<td>Stamp Tax</td>
<td>1040.34</td>
<td>527.82</td>
<td>512.52</td>
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<tr>
<td>Stamp Tax on Security Exchange</td>
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<td>527.82</td>
<td>16.34</td>
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<tr>
<td>Urban Land Use Tax</td>
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<tr>
<td>Land Appreciation Tax</td>
<td>1278.29</td>
<td></td>
<td>1278.29</td>
<td></td>
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<tr>
<td>Tax on Vehicles and Boat Operation</td>
<td>241.62</td>
<td></td>
<td>241.62</td>
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<tr>
<td>Tax on Ship Tonnage</td>
<td>26.63</td>
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<td></td>
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<tr>
<td>Vehicle Purchase Tax</td>
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<td>1792.59</td>
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<tr>
<td>Tariffs</td>
<td>2027.83</td>
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<tr>
<td>Farm Land Occupation Tax</td>
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<tr>
<td>Deed Tax</td>
<td>2464.85</td>
<td></td>
<td>2464.85</td>
<td></td>
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<tr>
<td>Tobacco Leaf Tax</td>
<td>78.36</td>
<td></td>
<td>78.36</td>
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</tr>
<tr>
<td>Other Tax Revenue</td>
<td>1.80</td>
<td>0.02</td>
<td>1.78</td>
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<tr>
<td>Total Non-tax Revenue</td>
<td>9890.72</td>
<td>1979.17</td>
<td>7911.55</td>
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</tr>
<tr>
<td>Special Program Receipts</td>
<td>2040.74</td>
<td>298.03</td>
<td>1742.71</td>
<td></td>
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<tr>
<td>Charge of Administrative and Institutional Units</td>
<td>2996.39</td>
<td>396.02</td>
<td>2600.37</td>
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</tr>
<tr>
<td>Penalty Receipts</td>
<td>1074.64</td>
<td>31.79</td>
<td>1042.85</td>
<td></td>
</tr>
<tr>
<td>Other Non-tax Receipts</td>
<td>3778.95</td>
<td>1253.33</td>
<td>2525.62</td>
<td></td>
</tr>
</tbody>
</table>

The Chinese Income Tax system has two main pillars: the individual income tax and the enterprise income tax. The individual income tax levies income tax on any individual resident of China on worldwide basis. The enterprise income tax is levied on Chinese and Foreign Enterprises. Chinese Enterprises are taxed on their worldwide income while Foreign Enterprises are taxed on their Chinese Sourced Income. The enterprise income tax law defines resident enterprise for the purposes of the law as any enterprise that was incorporated in China or has a place of effective management in China. As to source rules, the EIT applies for business income a source rule of "Establishment or Site" which is very similar to the international source rule of "Permanent Establishment". Any foreign enterprise that has an establishment or site in China will be taxed on all of its income attributable to this establishment. The term "establishment" is defined in article 5 of the EIT Regulations to be:

"an establishment or site for carrying on production and business operations in China. including:
• a place of management, business, or office (or place of administration);
• a factory, farm, or a place of extraction of natural resources;
• a place for providing services. “Services” include transportation, warehousing, consulting, scientific research, technical services, education and training, restaurant and hotels, agency, travel, entertainment, and processing;
• a place of construction, installation, assembly, repair, and exploitation (including building site, ports, place of exploration);
• a place of conducting other production and business activities”.

Article 7 of the EIT regulations includes the other main source rules which subject the sourced income to a 20% withholding Chinese Tax. The main source rules include the following: (a) The source of income from the sale of goods is the place of the sale transaction; (b) The source of service fees is the place where service activities occur; (c) The source of dividends and bonuses is determined according to the residence of the payer; the source of interest, rents and royalties is determined according to the location of the payer; (d) The source of other types of income will be determined by the tax authorities or the Ministry of Finance.

The EIT Law and Regulations elaborate on the taxable income by defining income as any realized income from the sale of goods, provision of services, transfer of property, dividends, interest, rent, royalties, donations and other types of revenues. The income is calculated on accrual basis according to

16 See: Jinyan Li, He Huang, The Transformation of Chinese Enterprise Income Tax: Internationalization and Chinese Innovations, CLPE research Paper 41/2008 Vol 04 No 08 (2008);
the law rather than accounting principles. The tax is levied on net income, after the deductions of deductible costs and expenses including straight line depreciation on fixed assets for different periods in accordance with the type of the asset. The tax rate is normally 25% while a lower rate of 20% applies to small enterprises and a special rate of 15% is given to "key state supported, new and high tech enterprises". To eliminate double taxation, the EIT law applies a dollar for dollar tax credit on foreign tax and tax treaties set the withholding rates in the range between 0% to 20%.

To attract foreign investments and advance other state policy goals, the EIT gives several tax incentives in different forms including exemption, rate deduction, accelerated depreciation, additional deductions and tax credit. As Jinyan Li explained, "High-tech enterprises receive several types of tax incentives, including: (a) reduced tax rate of 15% (EIT Law, Art.28); (b) exemption of income from transfer of technology (EIT Law, Art. 27); (c) additional deduction for research and development expenses (i.e., 150% of actual expenditure is deductible as current expenses or amortized as capital expenditures) (EIT Law, Art.30 and EIT Regulations, Art.95); (d) accelerated depreciation (EIT Law, Art.32 and EIT Regulations, Art.98); and (e) special deductions for eligible investors of high-tech enterprises. If a venture capital enterprise invests in the shareholdings of a private small or medium size new and high-tech enterprise by stock for two years or more, 70% of the amount of the investment may be deductible against the taxable income. The deductions can be carried over to the following tax year (EIT Law, Art. 31 and EIT Regulations, Art. 97)."17

The EIT contains several Anti Avoidance rules to minimize tax avoidance and maintain the Chinese Tax base. These rules include (a) a transfer pricing rule which applies the arm's length principle on transactions between related parties while the SAT Transfer Pricing Circular elaborate on the definition of related parties and the methods to set the arms length price; (b) a thin capitalization rule which prevents the deduction of interest on excessive debts owed to related parties; (c) a Controlled Foreign Corporation (CFC) rule which read as follows: "Where an enterprise that is established by a Chinese resident enterprise in a jurisdiction pays tax at a rate obviously lower than the tax rates as stipulated in Article 4 [of the EIT Law] and does not distribute its profits for reasons other than business needs, the amount of profit that should have been distributed to the Chinese shareholder is included in

17 Supra, at p. 15.
19 Supra, at p. 22.
the income of the Chinese resident”\textsuperscript{20}; (d) a general anti avoidance rule that adopts the "reasonable business purpose" test.

IV. The Challenges of Taxing E-commerce Income in China

The challenges of taxing E-commerce Income in China are similar to the challenges of taxing e-commerce in other countries but China has also its unique challenges. The first challenge is the determination whether e-commerce enterprise has an "establishment" or "Site" in China for the purposes of the EIT. This source rule relies on physical concepts and assumes that an enterprise needs such a presence to run business but in e-commerce environment such a physical presence is not necessary. E-commerce enterprise could sell intensively in China without any presence in the form of establishment or site. The logic of the establishment threshold is less clear in the era of e-commerce. This challenge is similar to the challenge that faces the "permanent establishment" threshold in the international context. This challenge presents a risk for the Chinese source tax base. This risk is especially important for China as developing country with huge consumer market that imports products from abroad.

Similarly, the application of the other source rules which rely on physical concepts and presence faces difficulties in e-commerce context which disregards physical limits. For example, it is not easy to apply the place of the sale transaction rule on e-commerce transaction because such a transaction has no place. The contract is made online and the delivery of the product is made on line in digital products and from different and easy manipulated place in the case of physical products which make it easy to escape the tax threshold. As well, the determination of where services occur in e-commerce services is not easy as such services are given online without any specific place of services. The determination of the place of online booking for example is very much different than the determination of the place of booking through a travel agency. The determination of the place of online banking services is very much different than the determination of the place of branch banking services. In e-commerce context the place of incorporation of enterprises is much more flexible which widens the possibilities of tax planning to reduce tax liabilities on dividends which is determined according to the place of the payer and to reduce tax liabilities on personal basis on Chinese enterprises. It is true that these tax planning

\textsuperscript{20} Supra, at p. 25.
opportunities are open for e-commerce enterprises as well as for non e-commerce enterprises but the opportunities for e-commerce enterprises are wider. This challenge has its unique feature in China as a result of the special relations and Geographic proximity between China and Hong Kong which is a low tax jurisdiction.

The Anti Avoidance Tax rules are difficult for application in China as a huge country with low tax compliance rate and especially in e-commerce context that makes it easier to avoid taxes. The application of the transfer pricing rule for example faces the challenge of determining the arms length price in e-commerce with the existence of very different transactions and the limited experience of the Chinese Tax Administration in comparison to developed countries in transfer pricing methods and issues. The CFC rule has its own difficulties in the Chinese e-commerce context as a result of the special relation with Hong Kong and the Geographic Proximity to it.

The Uniqueness of China relates to its huge population and geographic dimension and to its special stage of development in the internet and e-commerce context and in the administration of a modern tax system in an era of globalization while China is a leading trade player that joined the WTO in 2001. As a large country it has special difficulties to administer a tax system especially in e-commerce transactions. As an infant country in technology it has special difficulties in handling e-commerce tax issues while this commerce is growing rapidly in the country much faster than the development of the government technology skills and enforcement abilities. In addition, China has adopted the EIT in its current form as modern and international tax system just few years ago and it has limited capabilities and experience in running such a system in modern era. But the economy is growing very fast in a global manner which enforces the Chinese Tax Authorities and experts to handle these rapid changes while using insights and experience from other countries and experts.

I would like to end the discussion of the challenges by quoting Yang Liu & Li Hongchang, Chinese Economic Scholars, who discussed the challenges and proposed some policy responses: “The Influences of electronic commerce on the taxation system include, but are not limited to those listed below: 1) Electronic business shakes the foundation of the traditional taxation system for which voucher audit is the basis; 2) The computer encryption techniques increase the difficulty for the taxation department to obtain the concerning information; 3) It is difficult to make certain the standing body of the business dealers; 4) Electronic Commerce underlies the conflict of taxation jurisdiction between related
countries; 5) It is hard to recognize the product qualification and the product transfer price; 6) Electronic commerce greatly influences the prevailing taxation system; 7) The international tax aversion becomes more and more serious”21.

V. The Chinese Response to the Challenges

The Chinese Tax Administration or any governmental agency didn't issue any report or discussion paper on e-commerce taxation as did other leading countries. It seems that the discussion of the issue is very limited within the Chinese authorities and professionals. As one official stated in 2000, the Chinese are applying the same tax rules on e-commerce. In an interview with the news weekly Outlook22, Jin Renqing, director of the State Administration of Taxation (SAT), noted that some people had misunderstandings about e-commerce. "To put it simply, e-commerce refers to business transactions conducted on the Internet. It is, in essence, the same as those made in department stores," Jin was quoted as saying. "Considering the neutral principle of taxation and the protection of developing China's taxation jurisdiction, our country will not pursue a tax-free policy for the fast developing e-commerce," the official noted. Jin also revealed that the SAT has set up a special task force to focus on the study of e-commerce taxation23.

To my understanding, some change is taking place recently. Chinese officials have called for clearly regulating and imposing a tax on e-commerce. Zhu Yilong, member of the National Committee of the Chinese People's Political Consultative Conference (CPPCC), China's top political advisory body, made the announcement in early 2010 during the ongoing CPPCC session, that "Online shopping has become one of the mainstream commerce models in China, but few stores on B2C and C2C websites are registered or report their incomes to the taxation departments. We must fill the taxation vacuum"24. According to his proposals, the National People's Congress (NPC), the country's top legislature, should move to regulate the e-commerce industry, mandate the registration of online stores and require the payment of taxes.

In late 2010, the State Administration for Industry & Commerce issued "interim measures" that require online sellers to provide their real names and identification numbers to the shopping platforms where they open their online stores. Previously, some sellers registered with any name they wanted, and ID numbers were not required. Taobao.com handled more than two-thirds of China's online shopping in 2010, with 400 billion yuan in transactions. Its public relations manager, Yan Qiao, said there are two kinds of online stores on Taobao - those registered as companies and those that are not. Taxing a company or not "depends on whether it's a registered company, not whether it is an online shop", Yan said. He declined to comment on whether the government should tax online stores, but said that registered companies should pay tax. Liu, the tax law specialist, thinks that the regulations are the first step toward future taxing of online sales. "Following the providing of real personal information about online sellers, registering in the department of industry and commerce will be the next," he said.25

In Feb 2012, Eight Chinese government agencies jointly announced guidelines to promote e-commerce and e-invoicing26. These guidelines include the setting up of a trial e-invoice system, online information platforms and online payment standards, as well as the promotion of financial integrated-circuit (IC) cards. Feng Lin, a researcher at the e-commerce research center, argued that: “e-invoices have the benefits of being paperless and highly efficient and enabling globalization; the use of e-invoices could reduce e-commerce’s impact on traditional tax collection and management and build a foundation for future e-commerce tax collection; where the trial program increases product prices, this would be addressed through better supervision of e-invoice tax collection”27.

The introduction of e-invoices reflects the incorporation of some academic proposals made in China on the issue, including the proposal of Mix Xu & Luming Yang, who wrote in 2008 that: "The C2C e-commerce taxation should be based on the essential content of transaction and should not consider of the form of transactions. Governments and organizations have stressed that the abolition of tax barriers to promote the development of e-commerce. As part of e-commerce tax, it should also reflect the fairness of the C2C ecommerce taxation. We must give full consideration that China, as developing countries, also belong to the importation of electronic transactions, should not give up territorial jurisdiction, which will lose a lot of tax revenue. So we should stand in the purpose of national fundamental interests, adhere to the residents of the jurisdiction of both the principle of geographical

jurisdiction. Accordingly, they proposed to set up an electronic tax system that includes the establishment of specialized e-business tax registration system; the invention of e-commerce taxation software; the invention of electronic invoicing and clearly its force in law.

VI. Worldwide Responses to the Challenges

China could benefit a lot from the experience of the Academia, other countries and international organizations in handling e-commerce taxation challenges. For this purpose I will elaborate here in brief about worldwide responses to e-commerce challenges as I have discussed them in detail in my earlier research and scholarship. At the academic level, different proposals have been discussed in tax literature to cope with these challenges. I proposed to adopt an integrative adaptation model as learned from cyberspace law for the short run and a global e-commerce tax to fund global public goods for the long run. Professor Reuven Avi-Yonah proposed to levy a withholding tax on e-commerce income by the demand jurisdiction where the consumers of e-commerce reside. Professor Jinyan Li proposed to fix a formula for e-commerce taxation. Professor Richard Doerenberg proposed the tax base erosion approach. Sweet proposed exclusive residence taxation on e-commerce income.

At the national level, governments and tax authorities have studied the issue of e-commerce taxation and published rich reports and guidelines. Generally speaking, governments have applied the

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32 See JINYAN LI, INTERNATIONAL TAXATION IN THE AGE OF ELECTRONIC COMMERCE: A COMPARATIVE STUDY (2003);

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existing tax laws on e-commerce with some adaptations and have increased the use of technology in the administration and enforcement of the tax system. In some countries, like the United States for example, some substantial change was made in tax laws to cope with e-commerce challenges. Cross state e-commerce in the United States challenges the states’ sales and use tax system. Different proposals were raised at the academic level to cope with these challenges. However, ultimately three main measures were taken in the USA to handle the issue: First, the enactment of the Internet Tax Freedom Act; second, the signing of the Streamlined Sales and Use Tax Agreement (SSUTA); and third, the introduction of “Amazon Laws.” The Internet Tax Freedom Act was enacted in 1998 for a limited period of three years, which was extended later several times until January 11, 2014. The Act gives a moratorium on internet taxes and forbids any tax on internet access and any multiple or discriminatory taxes on electronic commerce. The Streamlined Sales and Use Tax Agreement harmonizes states sales and use tax laws. It harmonizes the tax base (Section II), the source rules (Section III), and the tax rates.
The agreement centralizes the administration of the tax (Section IV) and sets the rules for joining the agreement (Section VIII). Amazon Laws were introduced recently in New York, North Carolina, California and other states to overcome the nexus rules as designed in *Quill Corp. v. North Dakota* by using affiliated nexus construction. According to these laws, the physical presence of the affiliated partner in the state justifies levying state taxes on e-commerce and out-of-state sales. However, the constitutionality of these laws is not clear yet.

At the international level, in 1998, during the Ottawa Conference titled “Borderless World—Realizing the Potential of Electronic Commerce”, the OECD, its Committee of Fiscal Affairs (CFA) and participating countries concluded that “The taxation principles that guide governments in relation to conventional commerce should also guide them in relation to e-commerce. The CFA believes that... existing taxation rules can implement these principles.” The OECD designed broad taxation principles that should apply to electronic commerce as follows:

**Neutrality**

(i) Taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce. Business decisions should be motivated by economic rather than tax considerations. Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.

**Efficiency**

(ii) Compliance costs for taxpayers and administrative costs for the tax authorities should be minimized as far as possible.

**Certainty and simplicity**


(iii) The tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where and how the tax is to be accounted.

**Effectiveness and Fairness**

(iv) Taxation should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimized while keeping counter-acting measures proportionate to the risks involved.

**Flexibility**

(v) The systems for the taxation should be flexible and dynamic to ensure that they keep pace with technological and commercial developments.43

Following Ottawa, five Technical Advisory Groups (TAGs) continued the research and dialogue and issued several important studies and guidelines. One important report,44 discussed the application of the “Permanent Establishment” threshold as defined in article 5 of the OECD Model Tax Convention to e-commerce. Based on this report the commentary of article 5 was changed in a manner that distinguishes between computer equipment, such as a server, which might constitute permanent establishment under certain circumstances, and computer data, such as a website, which cannot have a location and cannot be a fixed place of business as required by the PE definition. The new commentary states that:

42.4 Computer equipment at a given location may only constitute a permanent establishment if it meets the requirement of being fixed. In the case of a server, what is relevant is not the possibility of the server being moved, but whether it is in fact moved. In order to constitute a fixed place of business, a server will need to be located at a certain place for a sufficient period of time so as to become fixed within the meaning of paragraph 1.

42.5. Another issue is whether the business of an enterprise may be said to be wholly or partly carried on at a location where the enterprise has equipment such as a server at its disposal. The question of whether the business of an enterprise is wholly or partly carried on through such equipment needs to be examined on a case-by-case basis,

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43 Id. at 4.
having regard to whether it can be said that, because of such equipment, the enterprise has facilities at its disposal where business functions of the enterprise are performed.

42.6 Where an enterprise operates computer equipment at a particular location, a permanent establishment may exist even though no personnel of that enterprise is required at that location for the operation of the equipment. The presence of personnel is not necessary to consider that an enterprise wholly or partly carries on its business at a location when no personnel are in fact required to carry on business activities at that location. This conclusion applies to electronic commerce to the same extent that it applies with respect to other activities in which equipment operates automatically, e.g. automatic pumping equipment used in the exploitation of natural resources.45

China could learn from the different country reports and discussion papers in making its own discussion paper. In applying the current Chinese tax rules on e-commerce, China could learn from similar application made in other countries. The progress in using technology in the administration of the tax system in different developed countries could be of a great benefit to China. The OECD guidelines and experience on the application of the permanent establishment rule to e-commerce could contribute a lot to the application of the Chinese Establishment or Site rule to e-commerce46. In studying and evaluating these rules and making its own rule China could gain a lot from the theoretical and analytical analysis of the issue and responses as researched by the rich academic literature.

VII. Conclusion

In conclusion, we are witnessing a real revolution in the Chinese markets by the rapid growth of e-commerce. This change presents challenges to the Chinese tax system which responds by different responses and introduces new tax rules. In introducing these new rules, China could gain a lot from the worldwide experience. At the same time, the world could also learn a lot from the Chinese responses and experience. We, the academics, could contribute to these developments and continue our research on this interesting and important issue of the taxation of e-commerce which will influence the public finance of governments in the next centuries.

45 Id. at 6.