

On China's Challenges in Taxation in E-business

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Abstract

The rapid development of e-commerce in the world has resulted in great challenges to the traditional taxation systems all over the world. As a developing country, China should take into careful consideration the characteristics of e-business and work out countermeasures to meet the challenges. This thesis at first offers an introduction to the characteristics of e-business and the different kinds of taxes in e-business, then gives an overview of the present taxation situation in e-business and analyzes loopholes in the tax laws concerning it, and finally provides some suggestions concerning online taxation in the development of e-business.

Key Words: e-Business, Tax, Tariff, Internet, Online Business

I. Introduction

Since the 1990s, China's information industry has been developing very rapidly. According to the Survey Report On Internet Development in China released in January 2003 by China Internet Network Information Center (CNNIC) at <http://www.cnnic.com.cn>, by December 31, 2002, there had been 208.3 million computers with access to the Internet in China and had been 371,600 websites registered at www by China. The

number of Internet users had reached 59.1 million, 66.9% of whom said that they would surely or possibly go e-shopping in 2003.

With the rapid development of the Internet all over the world, e-business web sites have been mushrooming. At present web sites dealing in e-commerce has amounted to as many as over 600 in China. Statistics show that e-business volume reached 0.2 billion RMB yuan in 1999, more than doubling that of 1998. It is predicted that the e-business volume will have reached 10 billion RMB yuan in 2002¹⁾. E-business volume in the USA in 1999 increased more than four times over the previous year. From November 26, 1999 to December 26, 1999 the number of orders reached 360 million and the selling volume reached US\$3.35 billion while the number of orders at the same period in 1998 was only 8.4 million and the selling volume was only US\$0.73 billion. The goods ordered through yahoo.com increased five times over the previous year during holiday seasons in 1999. Even the then president Clinton bought Christmas gifts through the Internet in order to keep up with the Joneses.²⁾

With the rapid development of e-business at the end of 20th century, e-commerce began to be regarded as the best short cut to become rich overnight. It will stimulate the growth of international trade and result in rich sources of tariffs while it also gives great challenges to our traditional taxation systems. Therefore it is a headache to the tariff collectors and tax administrators.

II. E-business and its Kinds of Taxes

Modern business has experienced the following three revolutions in succession: the appearance of large department stores, the rapid development of chain stores across regions and the appearance of e-business at the end of 20th century.

1. E-business

E-commerce refers to a series of trading activities in which inquiries, offer, ordering, production, marketing, warehousing, buying, selling, transportation and payment are through the Internet, Intranet, Extranet etc. so that the costs are reduced, the processes sped up, efficiency greatly improved. It is a radical revolution and represents the advanced productivity and is replacing our traditional storefront businesses and

1) E-commerce-the Deadly Enemy of Taxation?, www.chinabbc.cn

2) Zhou Wenlin. Appearance of Legislature in E-commerce. Market News, P.7. June 22nd, 2000. www.peopledaily.com.cn

has radically changed the way business was conducted.

An e-business is "an enterprise designed for success in the Information Economy. It brings into full play an organization's resources and partners in new and innovative ways to create clear strategic advantages. The potential of e-Business goes far beyond new technologies to impact and engage all aspects of a business strategy, process, organization, and systems to extend the business beyond its own boundaries where there are no boundaries..."

2. Kinds of taxes in e-business

The taxes of e-commerce can be classified into three categories according to the different kinds of trading on line.

1) Taxes on visible trade

We can levy taxes on visible goods sold on their web sites through the Internet just as we have done on goods sold in storefront physical businesses before. We do not have to change or adjust the way we collect taxes as a result of the arrival of the Internet era. The amount of taxes may be based on the trading volume or/and the profits of the store on the Internet regardless of the change of the means of trading.

2) Taxes on invisible trade

Invisible trade refers to the online services from services providers to their customers. The services are provided on the servers so that their customers may turn to the servers for inquiries or consultation, or the service providers send the required information to their customers upon request on the basis of agreed terms and conditions, such as some consulting services companies, web sites, and electronic newspapers and electronic journals whose customers/consumers and visitors/ readers have to pay the required charges in order to get the needed information or services through the Internet. Though the commodities are INVISIBLE, yet there is the flow of money or involves payment. The taxes are levied on the basis of the amount of payment or money flow.

3) Taxes on digitized information

The digitized information refers to computer software, books, music, pictures and visual materials sold in the Internet. The taxes levied on them are called royalties. The people concerned in different countries have

not agreed with each other concerning whether the digitized information is products or services since computer software is easily available on the Internet and consumers can download them from the Internet.

Ⅲ. The Current Taxation Situation in E-business

1. Loopholes in China's Traditional Taxation Laws Concerning E-commerce

With the rapid development of e-commerce, economic globalization is speeding up, the Internet services are getting increasingly easily available in China as well as in other developed countries. But e-commerce has been a hard nut to crack for tax administrators and tax/tariff collectors in the following manners:

1) The internet services are transnational and provide people with instant business communication across the globe. Therefore, there is no difference between domestic trade and international trade online in both timing and space. As a result, the definition and implication of international taxation has radically changed and it is difficult to levy tariffs on the goods across borders. It is NOT as easy as before to locate the tariff/tax payers, confirm the places of taxation and/or the amount of taxes or tariffs because of the changeability and movability of e-business operation and management.

2) E-commerce involves no paper work. The traditional sales/purchase contracts/confirmation and their related negotiation documents are now being replaced by the electronically interchanged data or digitized information. It makes tax/tariff evasion easier because it is difficult for the tax or tariff collectors to get hold of the evidences on which the taxes or tariffs are based.

3) There has arisen a dispute in taxation jurisdiction. Tax jurisdiction refers to the power or the right the government enjoys to levy tax/tariffs on goods and services under its jurisdiction. General speaking, in different countries in the world there are currently two principles regarding taxation jurisdiction. One is Residence Principle and the other is Citizen Principle. The former is that the users or consumers of the internet services must pay taxes to the government of the country where the servers are fixed and the internet service providers pay taxes to the government of the country where they reside. The latter is that the Internet service providers and their customers/consumers must pay taxes to their respective governments.

The dispute in taxation jurisdiction concerning e-commerce result mainly from the different taxation

practices or tax laws in different countries. For example, consumption taxes are traditionally levied in the places where the goods are supplied. In e-commerce the place where the main server is located is regarded as the place where the services or the visible goods are available and the country where consumers are located is regarded as consumption place. The visible goods and invisible services traded online makes the place unimportant and at the same time it is difficult to define the places over which the government exercises its taxation jurisdiction. Which government collects the taxes or tariffs on the software and the services online remains a problem to be solved, if the consumers or users are in Country A, the servers are located in Country B and invisible goods sold are in Country C. Which government levies the tariffs or taxes when the consumers buy visible goods from different countries through the Internet? At present the USA adopts the sales taxes system while the countries in Europe and China adopt the value-added taxes system. Under different taxation laws and systems in different countries, tariffs/taxes may be levied twice (double taxation) on the goods and services in international trade or the tariffs/taxes may be evaded completely.

4) The changeability and movability of e-commerce has made it more complicated and difficult for tax law enforcement departments to deal with international tax evasion than traditional storefront business because the parties concerned in international e-business transactions may amend them or erase their completed order forms and related documents, and then evade taxes/tariffs without leaving any traces. They may also conceal the truth of their transactions with repeated passwords which make it very difficult for tax law enforcement departments to find out the real total value or volume of their business transactions, to ascertain their tariff rates and the types of tariffs and the amount of tariffs to be levied. Because of the stores or shops on the Internet are changeable, it is difficult to locate the tax/tariff payers. Therefore, the fight against international tax evasion online will be complicated, tough and strenuous.

5) The coordination and cooperation of international taxation departments among different countries meet with challenges. With the rapid economic globalization and the development of knowledge-based economy, commodities, labor, technology and capital are circulating quickly in the world. Disputes among business partners in taxation in e-commerce may inevitably result. So it is necessary for the international community to strengthen coordination and cooperation. The coordination in this respect involves not only tariffs or duties, income taxes and double taxation; but also affects the different domestic taxation systems, policies and tax law-making. The international community have to cooperate closely in information exchange, technology transfer for tax/tariff examination and inspection. Because of the differences in the levels of economic development, in customs and values in different countries, the governments of different countries can not adopt the same tax examination technology and the same methods for tax examination, tax collection and supervision.

2. Great Losses in Taxes in E-business

In a research report, tax economist Professor Donald Bruce predicts that tax losses from trading online in all the states in the United States will amount to about US\$10 billion in 2003. Vermont and California will lose taxes amounting to US\$17.10 million and US\$1.49 billion respectively. Including the evaded taxes in other industries, the total tax losses in the United States will reach as much as US\$24 billion in 2003. Bruce says that the only traditional way to make up the loss of taxes is to increase tax rates. His research indicates that tax rates have to be increased by 0.5-1.0% in order to make up the tax losses.

Jesse Ancira, Director of Taxes in Auditing Office in Texas says that 55% of the taxes in Texas come from the sales market and that the loss of taxes in e-business amounted to US\$50 million 1999. Ancira says that taxes must be levied on all business transactions no matter whether they are conducted online or in the traditional storefront businesses so that tax equilibrium can be achieved.³⁾

E-commerce is better developed in the United States than in any other countries in the world. In 1997 the online business volume in the USA amounted only US\$6billion and by the end of 1998 it had reached US\$31billion, accounting for about four fifths of all the e-business in the world. The financial report released by the world-famous Intel indicates that Intel's income for the first quarter of 1999 was US\$7.1billion, about US\$3billion of which came from the sales online. It means that its monthly sales online amounted to as much as US\$1billion.

In addition, the income of the e-business giant, Cisco from the sales online in the fourth quarter of 1999 reached over US\$2billion while the daily sales online of the PC producer, Dell reached US\$10million. In early 21th century, e-business will be the mainstream of all the international business transactions. Forester predicts that business online will reach US\$842.7billion in 2002. The latest prediction indicates that the e-business volume in world will have reached US\$1000billion in 2005.

From the above data, we can conclude that all the countries will sustain great tax losses with the rapid development of e-business if the authorities concerned do not take any effective measures⁴⁾

3. The Conflict between Interest Groups

There exists an interest conflict between developed countries and developing countries in the rapid

3) Loss in Taxes on E-business Totaling US\$11billion. www.homepage.yesky.com

4) Yu Qingwen. Researcher in China National Information Center. Research in E-business Legislation. <http://netrule.home.chinaren.com>

development of e-commerce. The conflict is related to the e-commerce legislation and working out rules and policies concerning e-commerce.

For example, the government of the United States has made great efforts to urge WTO to adopt the Zero Tariff policy in international e-business transactions. The American trading ambassador once submitted to WTO a proposal that uniform rules concerning tariffs in e-commerce be adopted and zero tariffs be levied on goods and services in international e-business. It is evident that this proposal is in the best interest of developed countries, especially the USA since few countries or no developing country has levied any taxes on online goods and services now because of their underdeveloped e-business. If the proposal were adopted, it would put the domestic firms in all the developing countries into such a very disadvantageous position that their young industries would suffer greatly. Therefore, the Egyptian representative twice warned to WTO that developing countries might get no benefits from international e-business if the proposal were adopted. The Trading Development Committee of WTO are considering how the interests of developing countries are protected in the era of e-commerce.

Now China has no rules or laws concerning the taxes or tariffs on e-business transactions. It is an urgent task not only for China, but also for other developing countries in the world to draft rules or laws regarding taxes or tariffs on domestic and foreign e-business in order to meet the challenges in the era of the Internet and the knowledge-based economy.

IV. Suggestions on the Legislation concerning E-business Taxes

1. The Challenges in Taxation in the Development of E-business

As indicated above, the rapid development of e-business has resulted in great challenges for tax administrators and collectors because

1) The instant international e-business communication between parties concerned involves no paper work and their movability and changeability of e-business operation and management make it very difficult to track down the tax payers, to define the tax jurisdiction and to ascertain where or when to levy taxes or tariffs in the course of international or domestic e-business transactions.

2) The digitized information exchanged through the Internet and the contents in the electronic account book may be amended or deleted without leaving any traces, which makes auditing difficult or even impossible.

3) The security technology and anonymity in the e-business make it very difficult to track down the identities of the parties concerned in e-business and the details of the e-business transactions.

4) The tax administration system is far from perfect in terms of legislation. The methods of tax collection and examination and their related techniques are so outdated that they have not kept up with the rapid development of e-commerce. For example, most of the tax collectors and administrators are computer illiterate and do not know how to enjoy access to the Internet.

Taxation is the embodiment of country' s sovereignty. The taxation policies and laws of the countries vary with their levels of economic development. But the taxation policies for e-business in one' s country should not disagree with those beyond its borders in disregard of the boundlessness of e-business and instant e-business communication.

2. Suggestions

1) China should grant favorable tax policies to businesses online in the primary stage of the development of e-commerce just as we have done to the establishment of hi-tech enterprises in the hi-tech development zones all over China. Tax rates for business online may be lower than those for business in traditional storefront businesses in order to speed up the steady development of e-commerce. After e-commerce is getting well-developed, the granted favorable tax policies may be gradually cancelled. Or China' s tax/tariff revenue will decrease gradually with the popularization of e-commerce since business online is a very promising and highly profitable industry and in the long run it will not be helpful to the development of e-commerce because the government can not invest enough in the e-commerce as a result of the continuous loss of tax revenue.

2) The procedures for tax collection online should be easy, simple, convenient and transparent, not only for the Internet service providers and their customers, but also for the tax collectors and administrators.

3) The basic tax laws and principles concerning taxation jurisdiction for business online should be in conformity with international e-business practices and double taxation should be avoided.

4) China should strengthen international cooperation and protect the interest of the developing countries by saying NO to the zero tariff policy put forward by the United States.

5) Tax rates to be levied on business online should be based on our traditional taxation system in order to avoid great financial risks. We do not need to create new types of taxes for business online so that the neutrality and fairness of the traditional taxation system may be maintained and the reasonable disposition of financial resources may remain unchanged.

6) The sound system at all levels for tax and tariff collection and administration online should be set up. The tax collection online includes electronic tax/tariff declaration and payment so that distance declaration and payment may be materialized, work efficiency and accuracy in tax collection and administration may be improved and taxes and tariffs due may be in place on time. Banks, the Customs, Internet service consumers and providers, and the parties concerned in business transactions have to be connected on line with one another. We should exercise reinforced taxation supervision and conduct inspections online so that taxes/tariff evasion may be tracked down and legally dealt with in time.

7) We should speed up the training of highly qualified tax collectors and administrators for the era of e-commerce and increase the investment in the infrastructure for e-commerce. The tax administrator and collectors should adapt themselves to the new situation of e-commerce and update their traditional way of tax/tariff collection and administration and equip themselves with a sufficient knowledge of taxation laws and rules, good computer application skills and a good command of the English language. The development of computer software for tax/tariff collection and administration should be more updated than the development of e-commerce so that effective supervision over and inspection of tax collection may be exercised and evasion of taxes/tariffs online be eradicated.

V. Conclusion

The rapid development of e-business has resulted in great challenges for tax collection and administration. The Chinese legislature and the Chinese government should work out related rules, policies and laws to keep up with the trend of e-commerce so that we can adapt ourselves to the era of the Internet by getting rid of our old-fashioned thinking and traditional way of taxation, by setting up a sound system for tax/tariff collection and administration online, by training highly qualified taxation personnel and by adopting the up-to-date means of tax collection, administration, supervision and inspection to make sure that e-commerce will be developed and expanded in an orderly and fair way, evasion of taxes and tariffs may be eradicated. The taxes/tariff to be levied on e-business may contribute substantially to China's national revenues.

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국문초록

최근의 전자상거래의 급격한 발전으로 국제경제환경의 급속한 변화를 초래하고 있는데 특히 전통적 세제시스템의 경우에도 예외는 아니어서 전자상거래시스템에 적합한 세제시스템의 개발이 논의되고 있는 상황이다. 그러나 국제적으로 전자상거래와 관련한 세제시스템의 개발이 완성되지 않고 각국별 또는 국제회의에서 논의되고 있는 상황이라고 할 수 있다.

중국에 있어서 새로운 세제시스템을 개발하기 위해서는 우선 중국의 e-business의 성격의 파악하고 이에 근거한 세제시스템에 대한 대책을 마련해야 한다. 본 논문은 먼저 e-business의 특성과 e-business에서의 다양한 세제형태에 대하여 알아보고, 둘째 e-business에서의 세제현황 및 세제관련 법의 문제점을 고찰해 본다. 마지막으로, e-business의 발전과 더불어 야기되는 온라인 세제에 대한 몇 가지 제안 및 시사점을 제시한다.