

Research on the Development of China's Digital Services Tax Legal System

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ABSTRACT

The sustained and vigorous development of the digital economy is profoundly reshaping traditional economic operating models. This transformation simultaneously impacts the existing tax legal framework and poses significant challenges. Establishing a digital services tax legal system compatible with digital economic development has become an inevitable choice. Grounded in the specific realities of China's digital economic development, this paper thoroughly examines the theoretical basis for establishing a digital services tax legal framework. It analyzes the current challenges in advancing this system, including gaps in the legislative framework, double taxation in cross-border transactions, and insufficient supporting enforcement mechanisms. The paper also proposes a pathway for establishing a digital services tax legal system tailored to China's fundamental national conditions. It addresses three dimensions: clarifying the fundamental objectives and basic principles of legislation, refining the hierarchical legal framework, and detailing the specific implementation measures. It aims to foster synergistic and sustainable development between the digital economy and the real economy.

KEYWORDS

Digital economy; Digital services tax; Legal system

1 Introduction

A *Plan to Facilitate Development of the Digital Economy in the 14th Five-Year Plan Period (2021-2025)* explicitly proposes to "improve the digital economy governance system," "strengthen collaborative governance and regulatory mechanisms," and "enhance tax supervision and tax audits." This series of measures provides a clear direction for establishing a legal framework for digital services taxes^[1]. As the scale of the digital economy continues to expand, its pivotal role in the national economy is becoming increasingly established. Digital services, in particular, serve as a direct driver of economic growth. However, the traditional tax law framework remains insufficiently adapted in areas such as taxpayer identification and tax base calculation standards, leading to issues like tax leakage and imbalanced tax burden distribution. Currently, numerous countries and regions worldwide have issued policy documents related to digital services taxes, with some economies having completed legislative implementation and entering the enforcement phase. As an economic entity, China possesses dual attributes as both a digital enterprise hub and a digital consumer market. Establishing a scientifically sound and internationally compatible legal framework for digital services taxation is not only a crucial measure to safeguard national tax sovereignty, but also an essential pathway to promote the standardized development of the domestic digital industry. Moreover, it represents a pivotal step in participating in the global process of reshaping tax rules.

2 Theoretical Foundations for Establishing China's Digital Services Tax Legal Framework

First, tax equity theory serves as a crucial pillar for constructing the digital services tax legal system. It mandates that the actual tax burden borne by taxpayers must correspond to their tax-paying capacity. During the rapid expansion of the digital economy, certain digital enterprises have leveraged data monopoly advantages to accumulate excess profits while maintaining persistently low tax burdens. This has created a significant tax imbalance between them and traditional physical enterprises. The implementation of a digital services tax can correct this imbalance at the level of tax system design. Second, the theory of tax jurisdiction also serves as a crucial basis for China's digital services tax legal framework. Under the digital economy, traditional permanent establishment rules can no longer accommodate innovative transaction models. It is imperative to redefine taxing rights through new nexus rules to safeguard the core tax interests of market-hosting countries.

3 Practical Challenges in Establishing China's Digital Services Tax Legal Framework

3.1 Institutional Challenges Arising from the Absence of Specialized Legislation

China's current tax framework was established under traditional economic conditions. The core rules governing value-added tax (VAT) and corporate income tax are designed around physical transactions and offline services, lacking precise

definitions for the virtual and cross-regional characteristics of digital services. The scope of “services” delineated in the draft VAT law still centers on face-to-face delivery as the core criterion, failing to encompass the operational models of digital enterprises providing services through cloud servers and cross-border network nodes. Consequently, the business revenues generated by such enterprises through data flows remain difficult to effectively tax. Meanwhile, the *Corporate Income Tax Law* relies on the physical requirement of a “permanent establishment” to distinguish between resident and non-resident taxpayers. Since digital service provision does not necessitate a fixed physical location, this directly results in a lack of clear basis for tax authorities to determine the taxpayer status of relevant enterprises^[2]. Meanwhile, the *E-Commerce Law* addresses the general tax obligations of e-commerce operators solely from the perspective of market regulation. It fails to elaborate on the taxable objects, tax bases, and collection procedures for digital services in accordance with tax law principles, thereby leaving a gap in specialized tax legislation. Furthermore, the bilateral and multilateral tax treaties China has signed perpetuate the “physical presence” principle for determining permanent establishment, enabling certain cross-border digital enterprises to evade tax obligations and creating significant loopholes in the taxation process.

3.2 Risks of Double Taxation and Tax Burden Shifting

The cross-border nature and high liquidity of digital services readily trigger double taxation risks. While the market country of digital consumption exercises its taxing rights over digital service revenues, the resident country of digital enterprises must still levy income tax on the company's global earnings. This forces the same digital service-related income to face taxation by two sovereign nations. Internal design flaws within tax systems further amplify the potential for duplicate taxation. After paying the digital services tax on service revenues, digital enterprises may still require users to bear value-added tax (VAT) at the consumption stage for the same services. This creates a cumulative effect where two distinct taxes target the same service value chain. The issue of tax burden shifting becomes increasingly prominent in this context. Digital enterprises with technological advantages and market dominance can adjust their service pricing strategies to pass on the digital services tax costs to end consumers. Such shifting directly undermines the core principle of tax fairness. More critically, traditional double taxation avoidance clauses in existing international tax treaties are built upon the economic model of physical operations. They fail to adapt to the virtual and cross-border nature of the digital economy. This not only fails to alleviate the existing contradictions of double taxation and tax burden shifting, but also exacerbates the difficulty of resolving the entire issue at the international coordination level.

3.3 Risks of Inadequate Tax Administration Safeguards and Institutional Alignment

Current tax information sharing mechanisms remain underdeveloped. Information connectivity between tax authorities and digital platforms, as well as cross-border service providers, faces significant bottlenecks, directly undermining tax administration efficiency. Tax informatization lags behind the pace of digital economic development. Tax-related information from digital services exhibits both high mobility and concealment, posing substantial obstacles for tax authorities in obtaining complete and accurate tax data^[3]. Traditional tax jurisdiction allocation rules exhibit clear limitations. Determining the actual center of management under the residence-based taxation rule for digital enterprises proves challenging, while the permanent establishment criteria under the source-based taxation rule struggle to align with the characteristics of digital business operations, resulting in ambiguous tax jurisdiction delineation. The rapid iteration of digital technologies further intensifies tax oversight pressures, exacerbates information asymmetry in tax matters, and highlights the relative obsolescence of tax audit regulations. These factors collectively constrain the effective administration and collection of digital services taxes.

4 Specific Pathways for Establishing China's Digital Services Tax Legal Framework

To address the aforementioned practical challenges, the establishment of China's digital services tax legal framework can be advanced through coordinated efforts across the following dimensions:

4.1 To Clarify Legislative Objectives and Fundamental Principles

The establishment of a digital services tax legal framework must be grounded in two core legislative objectives. First, it should employ scientifically designed taxation systems to align with the operational characteristics and developmental patterns of the digital economy. This will guide digital enterprises to conduct business activities within a compliant framework, thereby promoting high-quality development of the digital economy. Second, it should balance the interests of digital enterprises of varying scales and types to dismantle unreasonable barriers in market competition. This fosters a

fair, transparent, and predictable market environment, supporting the sustained and healthy development of the digital industry. Building upon this foundation, the institutional framework must adhere to four fundamental principles. The principle of taxation by statute requires formal legislation to define core elements such as the criteria for identifying taxpayers, the scope of taxable objects, and the basis for setting tax rates. This ensures that both taxation actions and taxpayer obligations have clear legal foundations from the outset. The principle of tax efficiency emphasizes that optimizing tax administration processes must balance resource allocation efficiency at the economic level with collection and enforcement efficiency at the administrative level. This is achieved by simplifying filing procedures and integrating tax administration data to reduce administrative costs for tax authorities and compliance costs for taxpayers. The principle of tax equity mandates the elimination of tax burden imbalances across industries and enterprises. This is achieved through reasonable threshold settings and differentiated tax rates, ensuring all taxpayers fulfill their obligations equitably based on actual business operations. The principle of tax neutrality strictly limits the scope of tax intervention in market mechanisms. It prohibits preferential treatment for specific digital business models or entities, as well as discriminatory tax administration measures, thereby upholding the decisive role of the market in resource allocation. During the legislative process, it is also essential to thoroughly assess the developmental stage of China's digital economy. While safeguarding national tax revenues from erosion, sufficient space must be reserved for the growth of small and medium-sized digital enterprises and innovative digital business models. This approach aims to achieve a virtuous cycle between tax regulation functions and the developmental needs of the digital industry.

4.2 To Improve the Legal Framework

Establishing dedicated legal regulations for the digital services tax is a crucial step in institutional development, requiring a clear definition and scope of digital services. Entities directly providing digital services—such as online advertising service providers, digital platform operators, and data sales enterprises—should all be included within the scope of taxable entities. Concurrently, the developmental needs of small and medium-sized market entities must be taken into account. Drawing on the dual threshold model adopted overseas, a reasonable threshold should be set based on global business scale and domestic revenue to exclude small and medium-sized digital enterprises from taxation, thereby alleviating their tax burden. Improving tax administration regulations is crucial for effective implementation. The Tax Collection and Administration Law should be amended to improve the tax registration system. The tax registration obligations of platform operators and foreign digital enterprises must be clarified, with corresponding accountability mechanisms established to enhance enforcement effectiveness. Simultaneously, establishing tax information sharing mechanisms requires balancing efficiency with privacy protection. Under strict safeguards for taxpayer privacy, information exchange among tax authorities, digital platforms, and third-party institutions should be promoted, while standardizing the collection, use, and sharing of tax-related information^[4]. Moreover, participating in the restructuring of international tax rules is an inevitable choice for safeguarding national tax interests. The criteria for determining permanent establishments in bilateral tax treaties should be revised to include virtual permanent establishments, thereby expanding the scope of permanent establishments. China should proactively align with relevant international two-pillar solutions, establishing new nexus rules based on “significant economic presence.” Taxing rights should be determined by integrating factors such as revenue, user numbers, and digital presence. Close attention must be paid to international tax reform trends, and China must safeguard its voice in the international tax arena, through continuous participation in rule-making.

4.3 To Refine the Core Elements of the System

First, the definition of taxable entities must transcend traditional tax jurisdiction constraints. It should be clarified that any enterprise providing digital services and generating income within the territory shall be a taxpayer, regardless of its nationality or place of registration. This ensures tax fairness and avoids discriminatory treatment. Simultaneously, dual quantitative thresholds for user base and operating revenue should be established. Taxation should apply only to digital enterprises meeting specific user scale and revenue levels, enabling precise targeting of taxpayers while preserving sufficient growth space for small and medium-sized digital enterprises. Second, the tax base should focus on revenues generated by digital enterprises through various digital services, specifically covering common types such as online advertising revenue, digital platform service revenue, and data sales revenue. This should be supplemented by catch-all provisions to regulate emerging forms of digital service income, ensuring comprehensiveness and forward-looking scope of taxation^[5]. Third, the threshold for taxation must balance tax administration efficiency with business development needs. Drawing on practices from economies like the EU and India, a dual criterion should be established based on both global business scale and domestic revenue. For instance, enterprises failing to meet the threshold could be temporarily exempted from the digital services tax. Emerging digital enterprises and entities providing public-interest digital services could receive phased tax incentives based on their operational life cycle and service attributes. Fourth, the tax base

should be defined as total digital service revenue, allowing enterprises to deduct operational costs directly related to digital services to effectively avoid double taxation. A flat rate could be adopted. Considering China's stage of digital economic development and the need for international tax system coordination, the tax rate should be set below that of most countries imposing digital services taxes, thereby tangibly reducing the tax burden on enterprises.

5 Conclusion

The rapid expansion of the digital economy is pushing beyond the scope of traditional tax laws and regulations. Establishing a digital services tax legal framework tailored to China's developmental realities has become a critical task. This framework must be grounded in China's industrial structure and tax administration capabilities while incorporating international best practices in tax reform. Guided fundamentally by the principles of tax fairness and legality, efforts should focus on defining the scope of taxation, clarifying taxpayer obligations, and refining collection procedures to fill current legislative gaps and resolve practical challenges in administration. In the future, the implementation of the digital services tax legal framework will strengthen the exercise of national tax sovereignty, balance tax burdens across different business models, and curb unfair competition in the platform economy. This will clear institutional barriers for the deep integration of the digital and real economies, enhancing China's voice in shaping international tax rules.

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