

Views on the current tax policy of e-commerce in China

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This paper provides an analysis of the current tax policy on e-commerce in China and points out that tax policy regarding e-commerce is not a ‘vacuum.’ Based on foreign scholars’ research and analysis of relative elements, this paper concludes that the economic effects of tax policy on e-commerce do not need to be exaggerated. This paper further explains tax policies on e-commerce in foreign countries as models for China to follow. This paper suggests that we should clarify applicable tax policies for e-commerce, design tax policies under the framework of consumption tax reform, and put forward preferential tax policies that are beneficial to economic and business development, as well as presents some views on preferences that can be introduced at the current stage.

Keywords: e-commerce, tax policy, preferential policy

As the volume of Taobao’s e-business hit the trillion-yuan mark,¹ tax policies for e-commerce have once again become the focus of public attention. The National People’s Congress (NPC) and Chinese People’s Political Consultative Conference (CPPCC) delegates have raised concerns about e-commerce taxation in 2013 and 2014. In 2013, NPC delegates even submitted proposals on legislation of tax policies for e-commerce (Wang, 2013). As estimated by the Ministry of Commerce, the total transaction volume of e-commerce in 2013 reached over 10 trillion yuan, in which 1.85 trillion yuan was generated by online retail business. Without a doubt, given the fact that the impact of e-commerce is penetrating the economy and society of China, the issue of tax policies on e-commerce and its management has become pivotal issue. A number of studies on the subject are available in China, for instance, the Wuhan National Tax Bureau Research Group (2014), Bai & Zhang(2014), Li et al(2014), Mao (2013), Yue & Gao (2013), as well as others. There are, however, some problems with the current studies. For instance, some researchers still believe that tax policies on e-commerce are only a “vacuum.” Little research has been done on the economic impact of tax policies on e-commerce. Tax policies on e-commerce in other countries have not been fully explored, and some studies are out of date (e. g. some papers are still discussing the tax policy principle on e-commerce

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¹ By the beginning of December 2012, Jack Ma announced that Taobao e-business (TMall and Taobao platforms) has reached a turnover of over 1 trillion yuan, equivalent to the GDP of the 17th largest province in China for that year.

proposed at the Electronic Business Meeting held at Ottawa in 1998).¹ There are also mistakes in some of the research findings (such as mixing up policies of tax exemption for internet access and e-commerce sales taxes). Discussions about tax policies for e-commerce are still at an early stage and neglect important factors such as the economic environment in China and the latest developments of e-commerce.

This paper will investigate whether there is truly a “vacuum” in tax policies on e-commerce, the impact of such policies on the economy, and lessons China can learn from other countries, and offer some suggestions on improving tax policies on e-commerce in China. It should be noted that the focus of this paper is on tax policies, rather than tax management, which will be discussed in future studies.

1. Are tax policies on e-commerce a true vacuum?

This question has been discussed somewhat in the extant literature (Lu, 2014); yet, as it is relevant to what is to be discussed in this paper, it is worth sorting this subject as an introduction.

As for turnover taxes for the sales of goods, none of the current VAT(Value-Added Tax) related laws and regulations exempts e-commerce from tax duties. For instance, Article 1 of the *Provisional Regulation of the People's Republic of China on VAT* states that “all units and individuals engaged in the sales of goods, provisions of processing, repairs and replacement services, and the importing of goods within the territory of the People's Republic of China are taxpayers of the VAT and shall pay VAT in accordance with this regulation.” E-commerce, as a means of sales, should be subject to VAT. In defining “taxpayers,” according to Article 9 of the *Detailed Rules for the Implementation of the Provisional Regulation of the People's Republic of China on Value-Added Tax (Regulations hereafter)*, “Units” as mentioned in Article 1 of the *Regulations* refers to state-owned enterprises, collectively owned enterprises, privately-owned enterprises, joint-stock enterprises, other enterprises, administrative units, institutions, military units, social organizations, and other units.” For individual e-commerce business operators (or individual e-commerce owners), two definitions of “VAT taxpayers” might be applicable—privately-owned businesses and other individuals. According to Article 37 of the *Detailed Rules for the Implementation of the Provisional Regulation of the People's Republic of China on Value-Added Tax* states that “the scope of the application of the ‘VAT minimum threshold’ is limited to individuals.” The range of the VAT minimum threshold is stipulated as follows: (1) the minimum threshold for sales of goods shall be monthly sales amounting to 5,000 to 20,000 yuan; (2) the minimum for sales of taxable services shall be monthly sales amounting to 5,000 to 20,000 yuan; (3) the minimum for assessment on a transaction-by-transaction basis shall be sales amounting to a per transaction (or per day)

¹ On 8-9 October 1998, OECD held the first ministerial meeting on electronic business at Ottawa, Canada.

value of 300 to 500 yuan. So far, people tend to believe that for individual e-commerce owners, the annual sales amount of 240,000 yuan is exempted from VAT—as calculated in this rule (20,000 yuan/month * 12 months=240,000 yuan).¹ For individual e-commerce owners, another article is equally important. Article 15 of the *Provisional Regulations of the People's Republic of China on Value-Added Tax* states that “the following items do not fall inside the scope of VAT: (7) sales of used goods of one's own.” Article 35 of the *Detailed Rules for the Implementation of Provisional Regulations of the People's Republic of China on Value-Added Taxes* is further defined in (3) that “used goods of one's own refers to any used goods of an individual's own.” That means non-privately-owned businesses of individual e-commerce owners are exempted from VAT if all he/she sells are goods that he/she used. Notwithstanding, generally, individual e-commerce owners on C2C platforms in China cannot be subsumed under this category.²

In addition, when regulating cross-border e-commerce business, tax policies and preferences for e-commerce are clear either in terms of general regulations (*Issues Related to Adjustment to Management Methods on Cross-border Postal Packages of Individuals*, as per the *General Administration of Customs Announcement No.43* from 2010), or specific documents for cross-border e-commerce (such as the *Announcement on Bonded Import Models on Cross-border E-commerce Services* by the General Administration of Customs, Shu Ke Han [2013] No.59). For online purchases, the upper limit for tax exemption is 1,000 yuan; for those beyond such limit, custom clearance needs to be made according to applicable postage tax rates³ and the tax is levied on the actual transaction price. For amounts equal to or less than 50 yuan, the tax will be exempted.

Even excluding other laws such as income tax laws, given the above laws and regulations, it is unacceptable to say that the tax policies for e-commerce are a “vacuum.” However, there are still different views on what tax policies are suitable for e-commerce, when one takes into consideration the potential strength and development of this new form of business. Two elements are worth considering: the economic impact of tax policies on e-commerce and foreign experiences against the backdrop of the market economy. Following sections will explore these two questions and provide suggestions and implications on China's tax policies on e-commerce.

2. Economic impacts of tax policies on the development of e-commerce

As for the economic impact of tax policies on the development of e-commerce, there have

¹ This belief was first seen as a reaction to the proposal on law of tax collection for e-commerce raised by NPC representative Wang Tian.

² While few statistics are available, we can make inference on the basis of Taobao sales figures.

³ For personal postage items, tax rates are 10%, 20%, 30% and 50%.

been few empirical studies in China.¹ Naturally, extreme answers have been put forward in the absence of exact ones.² As a newly developed form of business, e-commerce is treated as the future of development and is eagerly anticipated and widely embraced.³ Therefore, tax policies on e-commerce by China's tax authorities have been created with prudence.

As for foreign studies, NBER(National Bureau of Economic Research) in the United States believes that the tax effects will decrease as e-commerce develops. Around 2000, studies (Brown, 2002) showed that if state sales tax is levied on e-commerce at the same level it is levied on traditional commerce, the number of online buyers would be reduced by 25%, dragging down online turnover by 30%. As e-commerce further developed, Alm (2006) showed that such an impact was undermining online sales, which shrunk by 6%. Such results were found in other study (Scanlan, 2007). A reasonable explanation might be that people are more familiar with, or even rely on, e-commerce. Therefore the tax effect on consumers' online purchasing ability is being reduced.

These results could shed light on the design of tax policies on e-commerce in China. Theoretically (tax preference aside), to strengthen the management of taxation on e-commerce will allow e-commerce businesses and traditional businesses to partake in fair competition. E-commerce will survive by reducing costs and improving efficiency (tax-like fees have already been levied on e-commerce businesses, such as management fee for platform charges by platform providers, which do not affect the development of e-commerce).⁴ Hence, taxes will not necessarily push up consumer prices. Though theoretically correct, the assumption that taxes would contribute to higher consumer prices is truly a reflection of some deep-rooted misconceptions in the business culture in China (i.e. the notion that businesses must transfer all costs to the consumer side).

Combining the practices in China with existed research results, we can initiate further investigation. First, we can look into consumer reactions to price changes to see the degree of elasticity. In other words, if all taxes have been transferred to consumers and the prices increase, how would consumers react? A foreign consumption research company, Alix Partners' research shows that the price factor is not among the most important factors that affect the purchase of 8

¹ In Bei & Zhang's (2014) research, model of impact from e-commerce development on real-store sales is too simple, and the impact co-efficient of -8.09×10^{-6} is not convincing and may require further study.

² Major opinion from online community holds that C2C, even some B2C survive by avoiding tax and keeping prices low.

³ On 6 March 2013, the official Weibo ID of Taobao reacted to the opinion of enhancing taxation on online stores by Zhang Jindong, the Chairman of Suning, saying that "we are not disagreeing with levying tax on e-commerce, but not now, not on small individual online stores, not on employment opportunities for young people, not on their hope and future."

⁴ E-commerce platform provider charging a fee for platform usage from e-commerce business owners has become a common practice both at home and abroad. On October 10, 2011, as the biggest B2C platform in e-commerce, Taobao announced that in 2012 the annual fee would be increased from 6,000 yuan to 30,000 yuan or 60,000, with deposit from 10,000 yuan to a range of 10,000 to 150,000 yuan.

types of consumer goods, such as daily consumption and home technology appliances(Li, 2008).¹ These 8 types of consumer goods are as follows: alcoholic beverages, leisure clothes, durables, cosmetics and beauty cares, daily consumption, home appliances, non-alcoholic beverages, and personal hygiene products. The research surveyed nearly 5,000 consumers in Beijing, Shanghai, Guangzhou, Chongqing, and Shenyang; analyzed influencing factors included products, price, service, channels, and experience.

Of all these factors, the product itself is the most important one for the purchase of these five types of goods, followed by service. For daily consumption, home appliances, and durables, Chinese consumers believe that services have the biggest influence on buying decision. Let's look into the growth of sales in Taobao and CPI. In 2012, CPI was up by 2.6% compared with the previous year, while turnover on Taobao grew to 1.1 trillion yuan from 500 billion yuan in 2011; if we look 10 years back, we can conclude that the price factor has not been the main driving force for sales growth. Furthermore, we conducted price and sales volume comparison between platform businesses and self-operated business, and no correlation was found between lower prices and higher sales volume. Therefore, for the growth of e-commerce business, the tax impact on prices should not be exaggerated.

In addition, in November 2013, Amazon launched its Australia website. Researchers compared the prices on the US website and Australia website: prices in Australia (including the goods and services tax, GST) were sometimes higher and sometimes lower than those on U.S. website, and the price difference did not always reflect the 10% difference in GST.

3. Lessons and experiences of tax policies on e-commerce in other countries

As e-commerce is inherently free from geographic limitations,² some believe that lessons and experiences regarding tax policies on e-commerce from other countries could be copied and applied to China. The truth is, for leading countries and regions like the European Union, Australia, and Singapore that are developed in e-commerce theories and practices, it is common to see that the tax policies on e-commerce and traditional business are similar. For example, as early as 2003, the EU had required VAT for sales from e-commerce—as they do for traditional sales. It is worth mentioning that when levying taxes on e-commerce, country-specific situations should be taken into consideration when designing tax preferences for certain industries, such as tax exemption thresholds and taxation on certain e-commerce products and services. Below is a brief on e-commerce tax policies in the US, Australia, and the European Union.

¹ It is estimated that one third of goods sold on Taobao is clothes and textiles, which takes up about one third of the market in China. The aforementioned industries are typical e-commerce industries.

² From practices across the world, we can see the e-commerce sometime does have some geographical limits for its global expansion, as restrained by tax policies, finance and settlement regulations.

3.1. Tax policies on e-commerce in the US

In May 2013, the US Senate voted 69 to 27 to pass the *Marketplace Fairness Act* proposed by Senator Mike Enzi, which authorized all state governments to collect sales tax from enterprises for products sold via the internet, radio, and televised commercial programming. The passing of this act aroused much coverage about no more tax-free e-commerce in the US. This so-called abolition was compared to the seemingly contradictory *Internet Tax Freedom Act*. However, the *Marketplace Fairness Act* was actually an act on state sales tax, whereas the *Internet Tax Freedom Act* exempted taxes for internet access services. Therefore, the two tax subjects are different.

It also needs to be clarified that in the US, sales tax is a state tax levied during the retail process at the point of sale. The tax-free policy for e-commerce was based on the verdict of the supreme court in 1992 on the case of the Quill Corp, a catalogue sales enterprise, “when a retailer sells products to consumers outside of the state, the state government is not allowed to levy sales tax on the retailer unless the retailer has enough department and volume of business in the state of the consumers.” With that, e-commerce businesses (internet retailers) believe that “sales to consumers in another state are only taxable when the e-business has a physical entity in the state of the consumers.”¹ Of course, some states expanded the scope of “entity” to cover sales companies hired by e-businesses or the subsidiaries of e-businesses. In fact, nationwide e-businesses have been paying sales taxes in different states for their sales for a long time. For instance, when Amazon, whose headquarter is in Seattle, Washington, set up warehouses in California, in September 2012, the California state Government required Amazon to begin paying sales tax. That means when a consumer in California buys goods from Amazon, Amazon needs to pay sales tax to the California Government. Complete statistics shows that for goods sold by Amazon or its subsidiaries’ websites, Amazon is now paying sales tax in at least 16 states.² When calculating total price at check out, the website calculates the total sales tax according to the sales tax rate in the state of the consumers and counts it into the amount.

Therefore, so-called “tax free e-commerce in the US” is a totally different concept from tax policy on e-commerce in China. For the US, policy change in 2013 for e-commerce involved replacing individual state sales tax with general state sales tax. China is improving the existing tax policies and management, and there is no “tax vacuum.”

¹ The relationships between turnovers to price, quality and service can be concluded from the sales ranking on Taobao. Through the impact of tax on sales volume cannot be directly observed, it can be deducted by looking at the price change and its impact on turnovers.

² The Supreme Court in the U.S. dismissed the appeal from Amazon for a hearing for e-commerce sales tax in New York State, which means that e-businesses that do not have a real store in New York State, such as Amazon, have to continue to pay sales taxes for its online sales.

3.2. Tax policies for special e-products: ATO¹

Goods and Service Tax (GST) levied in Australia during the circulation of goods and services have the same basic nature as VATs in China. All sales of goods and services other than financial products (including the sales of real estate, intangible assets, and imported goods and services) are taxable under the guidelines of GST. Under the GST framework, tax policies on e-commerce are further explained as falling under the heading of GST. Typical e-commerce tax policies are as follows.

3.2.1. Tax policies for services provided on the internet

The typical scenario of online advertisement services is as follows: first, an Australia resident enterprise launches an advertisement for its products and services on a website operated by another Australian resident enterprise; this is clearly taxable under GST tax policies and is handled the same way as traditional business. Second, if an Australian non-resident enterprise launches an advertisement for its products and services on a website operated by another Australian resident enterprise, according to the existing VAT policies, such a business is exempted from VAT. Third, if an Australian resident enterprise launches an advertisement for its products and services on a website operated by an Australian non-resident enterprise, this is not taxable under GST.

3.2.2. Special products: digital products sold online

If an Australian resident enterprise purchases digital products (like software) from a website operated by an Australian non-resident company, the income tax and turnover tax structures are as follows. The first is income tax. Generally, a non-resident company does not need to pay Corporate income taxes in Australia, unless the business is conducted by its permanent subsidiary organization in Australia. Having an independent Internet Service Provider (ISP) in Australia is not deemed as being a permanent organization in Australia and therefore does not need to pay income tax. However, if an Australian resident company pays a licensing fee to a non-resident company, in some cases royalty withholding taxes will be levied. According to GST laws in Australia, online sales of digital products by non-resident companies do not have a real connection with Australia, and such sales are not taxable under GST; however, if the resident company buyer of such digital products (software) is a financial organization that provides input taxed services and the software purchase is used to provide such services, the sale of software from a non-resident company to a resident company is taxable as the software is relevant to input taxed services. Yet, the taxpayer is not the non-resident company that sells the software, but instead the resident company that purchases the software, and the GST rate is 10% of the selling price of the software.

¹ Xie (2013) published a more detailed introduction on ATO.

3.3. *E-commerce policies in the EU*

For e-commerce businesses in the EU, such as Amazon and eBay, they have to pay VAT according to the VAT rates in the country of the consumers for their sales; sales of special goods (such as books, baby products, and daily products) are tax-free whether sold online or offline; for digital products (Kindle content, apps, and MP3s) a tax rate of 15% is applicable (3% for e-books). For consumers outside of the EU, there's no VAT, but the e-commerce website will have to pay an import withhold tax at a rate determined by the destination countries.

3.4. *Favorable policies for e-commerce*

On top of tax policies that are clearly made for e-commerce, countries (or regions) have put forward a series of preferential policies. Regarding tax thresholds, many countries set a threshold for goods sold by overseas e-commerce. For example, under GST laws in Australia, for a turnover of a certain amount or above (AUD\$75,000 for for-profit organizations and AUD\$150,000 for NGOs) that have a material relationship with Australia, the business should be registered as a taxpayer for the GST. Tax preferences for a company or individual purchasers of e-commerce should also be noted. In Singapore, besides the general tax rules for e-commerce, companies or individual purchasers can enjoy some tax discounts—the purchase of digital products in sciences or education do not have to pay taxes before 2013. For special goods and special buyers, there are some tax-free policies. In EU, some special goods sold online are tax-free. Also, disabled people and people with chronic diseases enjoy tax rebate.

Such tax preferences reflect the features of e-commerce and are made for the strategic development of the society where they are levied. They bring benefits to global business without compromising too much tax revenue for the countries involved.

4. **Implications for e-commerce tax policies in China**

After reviewing the e-commerce tax policies in China, economic impact and foreign experiences, this paper presents some implications and suggestions for e-commerce tax policies in China.

4.1. *To clarify tax policies which are applicable to e-commerce*

For disputed policies, it is important to clarify the tax duties. It should be made clear that e-commerce is different from traditional business only in the way goods are sold, and should be covered in turnover taxes. “Vacuum” policies for e-commerce defer the cultivation of tax-paying awareness for e-commerce.

On policy creation and management, based on the features of e-commerce and the analysis of

typical cases, there are some factors that are important regarding the taxation of e-commerce.

First is the tax type. Generally, the nature of e-commerce is to sell goods, hence VATs are applicable, as well as business tax if the business is providing services in the scope of business tax subjects.

Second is taxpayer identity. For most e-business, we are dealing with small-scale taxpayers. For those that reach the criteria of general taxpayers, they should be registered as such.

Third is the question of where to pay the tax. For companies that have entities within a specific country, they should pay taxes according to their place of registration. For companies that only have online stores, the location of the taxes should be clarified according to the place of the owner, departure place of goods, place of the consumer (place of consumption principal), place of the platform, or the place of household registration of the owner.

Fourth is that tax duties in e-commerce should be clearly defined. So far there is no duty requirement for parties in e-commerce. For instance, as a platform provider, it has no duty to report information as a third party, or other duties under tax laws. It should be made clear that such parties have duties to report information, as well as withhold or collect taxes on their behalf.

4.2. E-commerce tax policies based on the reform of consumption tax

Undeniably, e-commerce tax policies will have a profound impact on tax structures and economies in the coming 10-20 years. Certain policies may be beneficial in the short-term but may create loopholes in the future. Consumption tax policies would focus more on turnover taxes, instead of production, as they are now. For VAT policies that focus on production and sales, there is potential for structures that can ultimately generate revenue for local governments. Under the tax-sharing system, which is going to be the basic tax system for China in the mid-to-long term, investment should be curbed by more carefully designed tax policies. E-commerce tax policies can be a breakthrough in regard to this. For instance, the tax-payer location can be the place of consumption, as is the case in US sales taxes, and the generally accepted practice internationally.

More specifically, more options should be taken into consideration. For instance, when individual e-business owners register at local tax bureau, the owner can collect and pay turnover taxes on behalf of consumers directly to the provincial tax bureaus at the place of consumption. In the long run, large enterprise e-commerce can follow the same policies.

4.3. To allow tax preferences for e-commerce which are beneficial for economic development in China when conditions are met

With certain policy preferences for e-commerce in foreign countries, some hold different

opinions on whether e-commerce should enjoy tax preferences. Those who are against it (e.g. Wuhan National Tax Bureau Study Group, 2014) think that such preferences are unfair for traditional business, and could make it even more imbalanced when digital gaps are not yet bridged.

The paper believes that one should consider the economic situation of China. As mentioned before, some abnormal pricing models in Chinese society (which give birth to excessive profits in some industries) lack honesty. Poor product quality may be washed away by the development of e-commerce, but we cannot expect the power of e-commerce to be strong enough to fix such an issue completely. The power of taxation, as a government force, should at least be pushing toward these improvements.

Tax preferences should come with certain conditions. For now, there can be some preferential policies intended to encourage e-businesses to adopt relevant technologies and standards in some demonstration projects.¹ Such preferential policies are not unfair to traditional businesses. Given a free market admission for e-commerce, traditional businesses can increase their e-business so as to compete with e-commerce and create a better consumption environment and boost sales.

Tax preferences will bring about the following benefits: (1) to bring underground “low-price” benefits to light and make the advantages of “tax evasion” a fair competition advantage, so that competition can be more about a reasonable pricing and quality model that helps to earn profits for a business. China will get more tax revenue from the market, consumers will enjoy effective e-commerce so that all three parties—the nation, the people, and the businesses—can all benefit.

When designing preferential tax policies, one should be forward-looking and open-minded about policy scope, as to consider e-commerce and traditional commerce, as well as the newly developed third-party e-businesses. According to the research center at Alibaba, the number of third-party service providers on TMall and Taobao increased from 600 in 2011 to 2800 in 2012; the number of service tools increased from 1930 in 2011 to 8000 in 2012—a growth rate of over 400%. This reveals huge potential for a third-party service market.

4.4. Tax preferences to be implemented

Given the features of e-commerce, to cater to the needs of economic structure transformation and considering different demonstrative projects for e-commerce, the following preferential policies can be seen as feasible in terms of turnover taxes and income taxes.

First, for individual e-commerce owners, under the principal of “enhanced management, better

¹ In 2012, China had started pilot projects of online credit-worthiness, e-certificate, online payment and logistics in 22 e-commerce demonstration cities, proving valuable chances to explore ways to create a safe, convenient and reliable environment for e-commerce.

services, simplified procedures, and lowered tax burdens,” the tax threshold for turnover taxes can be adjusted upwards, and there is room for more tax exemptions in regards to income tax. For service companies in e-commerce (platform, logistics, and technology services), business-to-VAT tax policies and preferences for software companies should be considered to levy turnover and income taxes accordingly.

Second, it is feasible to introduce preferential tax measures for specific items in e-commerce. Lawmakers could consider providing tax relief for certain e-commerce companies such as those who provide baby products, milk powder, and foods; e-commerce companies who enjoy such preferences should follow requirements such as e-certification, quality tracking, and e-display of certification (for this, tax preferences can be seen as a subsidy for demonstrating such technologies).

Third, tax preferences for international e-commerce must be addressed. Along with the development of international e-commerce platforms, when protecting domestic tax revenue and strengthening management using big data technology, we should also support the international business of e-commerce operators and facilitate commerce on international platforms. Maintaining this ideal will help to design tax preferences so as to help boost the reputation of products made in China and bring convenience to global consumers by designing a catalogue of daily necessities that can enjoy tax preference.

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