The International Exploration, Controversies, and Implications of Digital Services Taxes[1]

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Against the backdrop of the exponential growth of the digital economy—characterized by high mobility, data dependency, and volatility—traditional international tax systems have encountered fundamental challenges that render them increasingly obsolete. As highlighted in the paper, a core dilemma lies in the mismatch between tax revenue allocation and value creation: transnational digital enterprises can generate substantial profits in market jurisdictions through online platforms without establishing physical "permanent establishments" (PEs), the traditional benchmark for tax jurisdiction. This disparity has led to severe base erosion and profit shifting (BEPS), exacerbating tax unfairness between digital and traditional industries—for instance, the effective tax rate of digital firms in the EU is roughly half that of traditional enterprises.

To address this imbalance, numerous economies, predominantly European nations such as France, the UK, and Turkey, have unilaterally introduced Digital Services Taxes (DSTs) as an interim solution. These regimes typically target revenue from specific digital activities rooted in "user participation theory," including online advertising, digital intermediation, and multi-sided platforms. DST designs vary across jurisdictions but share common features: they adopt revenue-based tax bases (rather than profits, accommodating digital firms' early-stage loss-making models), set global revenue thresholds (e.g., €7.5 billion proposed by the EU) and local revenue thresholds, and impose tax rates ranging from 2% to 7.5%. France, as a pioneer, implemented a 3% DST in 2019, while the UK adopted a 2% rate with tailored thresholds.

However, unilateral DST implementation has sparked intense controversies, as elaborated in the paper. First, it risks double taxation: since DSTs are not covered by existing tax treaties, resident countries (notably the U.S.) generally refuse tax credits for DST payments, leading to duplicate taxation of the same income stream. Second, the regimes face technical ambiguities, particularly in defining taxable services and allocating revenue across jurisdictions in a borderless digital ecosystem. Third, they have triggered trade frictions: the U.S. has designated DSTs in multiple countries as "unfair trade practices" and initiated retaliatory tariffs under Section 301, citing

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disproportionate impacts on American tech giants that dominate global digital markets (accounting for over half of the top 70 digital platforms by market value). Additionally, critics argue that DSTs' simplified design lacks economic efficiency, as the fiscal gains often fail to offset losses in consumer and producer surplus.

In response to these tensions, the OECD/G20 Inclusive Framework has proposed the "Pillar One" framework as a multilateral alternative, which the paper positions as a more sustainable long-term solution. Pillar One targets large multinational enterprises (MNEs) with global revenue exceeding €20 billion and profit margins above 10%, reallocating 25% of their "excess profits" to market jurisdictions based on sales revenue—breaking the PE constraint to align tax rights with value creation locations. Complementing this is "Amount B," which establishes simplified transfer pricing rules for basic marketing and distribution activities to reduce compliance costs. Unlike unilateral DSTs, Pillar One applies across industries (not just digital sectors), uses excess profits as the tax base (avoiding penalizing low-margin firms), and relies on multilateral consensus to mitigate trade conflicts.

For China— the world's second-largest digital economy, with a digital sector valued at 35.8 trillion yuan (36.2% of GDP) in 2019—the paper offers targeted implications. It advocates a cautious stance on unilateral DST legislation to avoid provoking trade disputes and harming "going global" digital firms. Instead, the paper emphasizes proactive participation in OECD-led rulemaking to safeguard China's interests as both a major market jurisdiction and a home to global digital platforms. Additionally, it recommends accelerating the digital transformation of tax administration, leveraging big data and artificial intelligence to enhance cross-border tax supervision and adapt to the evolving digital tax landscape. Ultimately, the paper concludes that balancing adherence to international consensus with protection of national tax sovereignty is key to China's response to digital tax challenges.