



GLOBAL DIGITAL TAXES IN INTERNATIONAL TRADE AND ITS URGENCE FOR INDONESIA

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ABSTRACT

Members of the Organization for Economic Cooperation and Development (OECD) and World Trade Organization are working together to exploring issues related to digital service product tax policies. The ability of digital companies that operate without the need to be physically present has sparked debates in international forums regarding the allocation of rights and tax rights reallocation agreements or nexus. Not to mention the physical absence of digital companies that makes jurisdictional constraints for State that want to collect taxes from digital companies. The scope of digital services makes it difficult for policy makers to define what digital service products are. This problem has led initiate international forums to reforms international tax regulations that are able to accommodate these interests. TOECD formed a Task Force Digital Economy to respond this problem and at the same time identify issues that are related to digital service product taxes to make it relevant.

Keywords: digital tax; digital economy; international trade.

I. INTRODUCTION

Globalization is not a new phenomenon; the term of globalization has been frequently used in so many aspects and has a very broad definition. There are various definitions related to this term and it makes economist, sociologist and historians have different approaches in explaining this phenomenon. Despite its broad definition, no one deny that the impact of globalization can be seen in every dimension of our civilization.

The rapid development of technology is one of many factors that brought globalization faster than before. Eric Schmidt on his book *“The New Digital Age: Reshaping: The Future of People, Nations and Business”* describes internet as an anarchy world.¹ The presence or absence of government’s role in internet will not stop innovation in the digital world. On that basis, according to him, internet plays an important role in the era of globalization. It opens the new world and expands the reach and connecting people of every single person in the world beyond the border of every nation. Several studies suggested that internet success stimulates international trade. The rapid development of information technology over the last decade has helped states are integrated with each other and removing the barriers to trade between them. Internet is also affected export behavior. Over the last decade, the number of exports is growing. Internet helps business owners reach their potential customers more broadly and it means the number of exports could be higher than pre-internet.

In recent years, ecommerce transactions are growing rapidly in every corner of this planet. The rapid of technology development in telecommunications sector has succeeded in making internet penetration growing rapidly. According to World Bank, when internet started gaining popularity,

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¹ Eric Schmidt and Jared Cohen, *The New Digital Age: Reshaping: The Future of People, Nations and Business*, New York: Alfred A. Knopf, 2013, p.1.

exports goods and services grew 8,4 percent from 21 to 29,4 percent. These numbers are the highest jump over the last 13 years before the internet era. Based on this data, it is so hard to deny that digitalization affects the entire global economy. The rapid development in the communication sector has contributed to a new borderless economy and it has also created a new opportunity. However, digitalization in the economic sector is not about economic growth and profits, but it is also about tax.

In the digital era, economic activities often occur in cross-border transactions and many digital companies do not have any physical presence in place where they are operating their business. However, this does not stop them from selling their own products beyond their jurisdiction. The internet has helped them to sell their products beyond the national border. Moreover, all of these digital companies can walk free without being taxed. A loophole in international taxation systems does not stop these digital companies from making profits in their destination countries and shifting their profits to their jurisdiction. The lack of response from regulators to anticipate this new trading behavior has sparked debate in international forums. This new technology needs a new rule that can be applied to impose taxes on digital companies that do not have physical presence in their destination countries where they are operating their business activities.

Over the last decades, foreign digital companies like Google, Netflix, Facebook, Amazon, and Spotify operate their business and make profits without having physical presence in their destination countries and then shift their profits to the countries where they are resident. However, this practice is legitimized by Base Erosion and Profit Shifting (BEPS),² an international taxation framework addressing an ongoing debate to establish regulations to direct tax for foreign digital companies with significant economic presence without having physical presence in the countries where they are operating their business activities. Unlike traditional or conventional companies that have physical presence to support their business activities in the destination countries, this type of company does not need physical presence for their business activities in destination countries.

Indonesia is the highest country for its contribution to gross merchandise value in the internet economy in Southeast Asia.³ E-commerce or electronic transactions contributed more than USD 32 billion and it was followed by service transportation and delivery orders on demand which contributed for more than USD 5 billion.⁴ With these numbers, Indonesia is one of the hottest digital economy spots that has so much potential to explore. However, there is no regulation in Indonesia that can provide or be able to tax foreign digital companies with significant economic presence which do not have physical presence in Indonesia. This makes taxation from income tax quite difficult to implement. Many tax regulations, especially in Indonesia, are determined based on the Double Taxation Avoidance Agreements (P3B) and permanent establishment (PE) in the form of physical presence. The absence of physical presence of internet companies has raised problems regarding tax policies. During the pandemic, the Indonesian government calculated their income projection from this sector to be valued at Rp 104,4 trillion. However, the Indonesian government cannot maximize tax revenue from this sector due to the limitations of tax regulations. This can be caused by the imposition of Income Tax on PMSE activities which will lead to double taxation. This phenomenon is not only faced by Indonesia, almost every single country on this planet faces the same problem of taxing foreign digital companies. This problem encourages the international community to reform international taxation rules, to accommodate this interest without harming either party.

² Syamsul Arifin, "Pentingnya Penerapan Protokol Kesehatan dalam Rangka Menurunkan Transmisi Covid-19", *Policy Brief*, No. 2, 2020, available at <https://covid19.ulm.ac.id/wp-content/uploads/Policy-Brief-02-Syamsul-Arifin.pdf>, p. 14.

³ *Ibid.*, p. 2.

⁴ *Ibid.*

Indonesia is a part of international forum that discuss this issue regarding import duties of intangible digital products. In accordance with the World Trade Organization (WTO) moratorium, Minister of Finance Regulation Number 17 of 2018 stipulates that the products that included in this category are not subject to import duties. However, Indonesia argues that the moratorium only applies to electronic transmissions and not to products that are registered electronically.

To addressing this issue, OECD established a Digital Economy Task Force to respond and identify issue related to taxation of digital service products. This Task Force resulted 15 action plans which is known as the Base Erosion and Profit Shifting Action Plan which are trying to address the issue related to tax avoidance by multinational companies and digital companies that do not have any physical presence in their destination countries. In the report of BEPS, OECD broadly divides two issues in the digital economy taxes into two parts, which is income tax (direct tax) value added tax (indirect tax). However, the fundamental issue such as definition of digital service products and the classification of products that are included in digital service product are remain unclear.

This article aims to identify and overview the issue related to digital economy taxes and the forms of digital service products itself and its urgency for Indonesia.

II. RESEARCH METHOD

The research method on this article used a normative judicial method, which is using legal norms as abasis of this research.⁵ This method was chosen by the author to find the legal basis, legal principles and legal doctrine to find answer that the legal problems faced.⁶ The author tries to research and study primary and secondary legal materials by analyzing the provision contained in international law and national law related to taxation, especially regulation that are related to digital economy. The research method is descriptive analytical, which the author describes and explains the problems clearly and all provisions regarding the legal aspects related to tax collection from digital service product revenues. In analyzing the data related to this research, the author uses a qualitative analysis which is intended to obtain clarity from the problems by referring to international treaties to digital taxa collection and legislation that applies as positive law and adjust accordingly with data and facts obtained in the field.

III. DISCUSSION

1. World Trade Organization and Digital Service Products.

1.1 The Role of World Trade Organization

The rise of internet is affecting of every aspect and stage in our life, including business sectors. Over the last decades, especially during this pandemic situation, transaction that come from digital platform has been growing exponentially. The rapid development on internet era allows trading activities to be carried out via electronic media⁷

At the Ministerial Conference in Singapore in December 1996. WTO has begun to address issue related to international trade in internet. WTO members were agreed to make an agreement related to information technology which is known as Information Technology Agreements whilst try to categorize product that belonged to technology and information industry. However, this agreement failed to

⁵ Soerjono Soekanto and Sri Mamudji, *Penelitian Hukum Normatif Suatu Tinjauan Singkat*, Jakarta: Raja Grafindo Persada, 2006, p. 13.

⁶ Muhammad Abdulkadir, *Hukum dan Penulisan Hukum*, Bandung: Citra Aditya Bakti, 2004, p. 52.

⁷ Ghansham Anand, Lintang Yudhantaka, and Manik Lingkar Katulistiwa, "The Perspective of Indonesian Law on Ecommerce: Validity, Liability and Dispute Settlement", *Padjadjaran Jurnal Ilmu Hukum*, Vol. 7, No. 3, 2020, p. 52.

addressing the issue to define and categorize digital services and products due the different political and economic interest among its members.

WTO regulates trade into two parts which are regulated in two international agreements related to international trade, General Agreement on Trade in Services (GATS), a multilateral agreement which covering international trade in services and General Agreement on Tariffs and Trade (GATT), which covering international trade related to goods. These two agreements were basically made with the aim of regulating liberalization of international trade. However, these two relevant agreements are failed to determine whether digital products should be treated as a product or as a service. One of main reason why WTO failed to identify and define what is digital product is there is different definition among its members to classify digital products. But in order to avoid a new trade regime, WTO members are generally agreed that digital service products should not be classified as something other than goods or services.⁸

There is unofficial consensus in the international community regarding the definition of a digital service products. A digital product is defined as a product that is not in physical form and is traded online in electronic form via internet which refers to any goods or services that are in some way available through internet. Moreover, there is one common usage distinction is often applied to goods and services is that goods are tangible whilst services are intangible.⁹ This is one of main reason why WTO are still struggling to reach a legal instrument to treat digital product.

As this article mentioned above, the wide scope of digital services makes it difficult for regulator to define what a digital service product is. Moreover, the stakeholders in this area are still having trouble to identifying the problems that exist in the digital economy. The fundamental difference between the digital economy and conventional business lies in the ability of digital product companies like Google, Amazon, Netflix, Spotify and Facebook to generate income without having physical presence in their destination countries. It makes difficult for stakeholder to determine where their income comes from due to the tendency of intangible or tangible characteristic of digital service products.

The WTO was established to liberalize international trade, this includes digital economy that has characteristic of goods and services. However, WTO failed to identifying this issue due special characteristic which can be found on digital products. Some digital product has some characteristics of goods and services that should be treated as goods which are not part of GATT. However, this does not mean that digital service products are part of GATS subject. On OECD report, Addressing the Tax Challenges of the Digital Economy – Action 1, OECD are trying to resolve these problems by identifying the revenue models on digital business. There are eight revenues models in digital business: (i) revenue from advertising; (ii) sale or rental digital contents; (iii) sale of goods (including virtual goods; (iv) revenue from subscription fees; (v) the sale of services, including traditional services provided digitally such as brokerage services and consulting services; (vi) revenue from licensing content and technology, including journals or publications, algorithms and software; (vii) revenue from sales of user data and customized market research; (viii) income from hidden costs and losses, generally occurs in an integrated business model between online and offline operations (online and offline) where profits and losses can be attributed to the company's online activities but cross-subsidies occur naturally and are difficult to separate and identify (e.g. mobile banking services provided free of charge but subsidized by other banking services and fees).

⁸ Stewart A. Baker, Peter Lichtenbaum, Maury D. Shank, and Matthew S. Yeo, "E-Products and the WTO", *The International Lawyer*, Vol. 35, No. 1, 2001.

⁹ Sam Fleuter, The Role of Digital Products Under the WTO: A New Framework for GATT and GATS Classification, *Chicago Journal of International Law*, Vol. 17, No. 1, 2016, p. 5.

The broad definition to define what is digital product is one of the major reasons that needs to be resolved. To addressing this issue, OECD needs to find multilateral solution to tackle this issue. In 2015, OECD established a Digital Economy Task Force to respond and identify this issue related to taxation of digital service products. The Task Force resulted 15 action plan which is known as the BEPS Action Plans, which are trying to resolve issue related to tax avoidance by multinational companies and digital companies like Google, Facebook, Alibaba, Amazon, TikTok, Netflix and Spotify. In the report of BEPS 1, OECD broadly divides this issue into two categories. However, as I mentioned above, this report failed to define and identifying digital service products. One of particular concern that are still unclear of this term is to answer that electronic transmissions is a part of content or carrier.¹⁰ Developed countries such as the United States and European Union members and other countries that are exporters of digital products and services view the term of electronic transmission as digital trade content.¹¹ Otherwise, net importers countries like Indonesia view this term referring to electronic carriers so they can levy taxes on growing inline trade content.

1.2 Digital Elements in Tax-Disruptive Business Model

The rise of digital economy over the last decades has been placing pressure to international tax forum to establish a new method to impose tax from digital companies with significant economy presence. Unfortunately, stakeholders and policy makers are still debating to identify and define what is digital product. The first challenge that needs to be solved is the conceptual question about what digital is. Digital refers to binary digit (0 and 1) that represents signal or absence. In other words, something called digital if it uses data-encoding technology.¹² Any elements of an economic transaction that relies on data-encoding technology can be considered as a digital content.¹³ Business model that relies on digital elements like digital content, digital payments, digital distribution and digital communication is considered as a part of digital economy.¹⁴

These digital elements have characterized to disrupt the conventional business that may require special treatment to impose tax from companies that use in this business model. In other words, the companies that use digital elements on their business model are considered tax-disruptive. However, it is important to distinguish between the use of digital technology to enhance existing business functions and the core of role of digital technology in the advent of tax-disruptive realities.¹⁵ For example, there are two companies that sell the same tangible goods, one has physical store that accept cash payment. On the other side, the other store can only be accessed with online website and only accepts online payments methods like credit card, debit card or other payment methods. Even these two companies have similarities that require infrastructure like storage, inventory and distribution. Both companies have difference approach due regarding the physical presence. This business model that sells tangible goods that lack of physical presence must be analyzed separately compare to conventional business model even though they have similar economic presence. Furthermore, the rapid development of digital technology has enabled a new business model to operate differently from conventional business

¹⁰ Wallace Cheng and Clara Brandi, "Governing Digital Trade – A New Role for the WTO", German Development Institute, Briefing Paper No. 6, 2019, available at https://www.die-gdi.de/uploads/media/BP_6.2019.pdf, p. 1

¹¹ *Ibid.*, p. 1

¹² Christian Oliver Lucas-Mas and, Raúl Félix Junquera-Varela, *Tax Theory Applied to the Digital Economy: A Proposal for a Digital Data Tax and a Global Internet Tax Agency*, Washington, DC: World Bank, 2021, p. 8

¹³ *Ibid.*, p. 8.

¹⁴ *Ibid.*

¹⁵ *Ibid.*

model.¹⁶ This tax-disruptive business model has characterized by the lack of physical presence in the place where they operate their business activities. Since their presence to deliver their content are digitally automated, this means companies that practices this digital business model do not have physical infrastructures to deliver their digital content in the jurisdiction where they operate their economic activities. However, the lack of physical presence has significant economic presence that affects economy circumstances in the place where they operate their business. For example, digital companies like Netflix and Spotify do not need physical presence to provide and deliver their digital content in the market destinations. Therefore, traditional or conventional companies that sell or rent physical products like DVD, CD and cassette require physical presence to deliver their products. This means digital companies like Spotify, Hulu, Adobe and Netflix, that use subscription business model must be treated differently compares conventional business model.

More precisely, this new business model is capable to deliver their intangible goods untraceable without having physical presence in the jurisdiction where they operate their business model.

1.3 Digital Tax Subject

Historically, taxation has been existed since the dawn of civilization. It evolved through times and times and adapted to our social system. The notion of permanent establishment became common since the post of World War II. Since then, taxation system is still volving and adapting to our current social systems and economy. The current regulations have not been able to accommodate the income tax obtained by digital service product companies that do not have an office in the form of a physical building. The current regulations are only able to regulate the tax object of the income tax imposed for permanent establishments that have physical offices in their operating countries. The concept of Permanent Business Entity itself is made to determine the taxation rights of a source country (participant of the agreement) on operating profits obtained by companies that are residents of other treaty partner countries.¹⁷

In Indonesia, tax subject is regulated in article 2 (2) Law 7 1983. The definition of tax subject in this article has been amended or replaced several times, including the latest amended on Law 38/2008. According to this Law, tax subject are categorized into to subjects, domestic tax subject and foreign tax subject. The concept of permanent establishment emerged in article 4 (1) Minister of Finance Regulation (PMK) No 35/PMK.03/2019 for foreign residents which conduct business activities in Indonesia. However the definition of permanent establishment on article 5 are limited to foreign companies which having physical presence or infrastructure in Indonesia. Whilst most of foreign digital companies do not have any physical presence in Indonesia.

There are several conditions that must be met in order to form a Permanent Business Entity as follows: a) The existence of a place of business (place of business test); b) The place of business is established in a certain location (location test); c) Tax subjects must have the right to use the place of business (right use test); d) The use of the place of business must be permanent or for a period that exceeds a certain period of time (permanent test); e) Activities carried out through the said place of business must be a business activity as defined in the domestic provisions and P3B (business activity test); and f) If any of the above conditions are not met, the Permanent Business Entity will not be formed.¹⁸ Even so, not all places of business or business entities can immediately become permanent

¹⁶ *Ibid.*

¹⁷ Herlina Utamawati and Suparna Wijaya, "Pajak Penghasilan Dari Ekonomi Digital atas Cross-Boarder Transaction", *Jurnal Online Insan Akuntan*, Vol. 3, No. 2, 2018, p. 135-148.

¹⁸ *Ibid.*, p. 135-148.

business entities. In the United Nations Model Double Taxation Convention between Developed and Developing Countries (UN Model), which was also adopted in the P3B Indonesia and Singapore, it was stated that a form of Permanent Business Entity is not considered if: a) The use of the facilities is solely for the purpose of storing or displaying goods or merchandise belonging to the company; b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display; c) the maintenance of a stock of goods or merchandise belonging to the company solely for the purpose of being processed by another company; d) Management of a place permanent business solely for the purpose of purchasing goods or merchandise or for gathering information for the enterprise; and e) The maintenance of a fixed place of business solely for the purpose of advertising, or to provide information, for scientific research or for similar activities of a preparatory or auxiliary character for the company.¹⁹

Unfortunately, the requirements related to the required Permanent Business Entities are biased when faced with the activities of digital companies today. As the author has stated above, one of challenges to impose tax from digital companies such as Google, Amazon and Facebook is the ambiguity and insignificant place of business, location, and permanence, which raises the challenge of determining taxation rights for destination countries to impose tax from these companies. On this basis, many digital companies refuse to pay taxes because they think they are not a part of tax subjects that are permanent business even though these companies have significant economic presence.

As the author has stated above, in 2015 the OECD has formulated 15 action steps that are formulated into Base Erosion and Profit Shifting (BEPS) to addressing tax problems for digital service products, it is related to taxes obtained from digital service products which is expected to generate consensus in the international community regarding digital taxes. This is because conventional tax regulations are considered no longer able to accommodate digital economy taxation. In April 2020, the OECD/G20 Task Force on The Digital Economy (TFDE) conducted a digital tax discussion that focused on two things. First, the taxation of income generated from digital activities allocated in each relevant jurisdiction, where taxation rights must consider the amount of user participation, intangible assets related to marketing functions and the existence of significant economic activities. Second, the development of regulations related to the set of rules for the imposition of minimum tax rates that can be applied globally and other issues related to tax avoidance, including digital concept presence in an effort to determine the status of a Permanent Business Entity.

To determine the criteria for a Permanent Business Entity to have a digital presence, the tax subject must have met criteria such as: a) A significant number of contracts for the supply of digital goods and/or services between the company and local consumers, where these contracts are signed remotely; b) Digital goods and/or services provided by are widely used in the country; c) The amount of payments of substantial value made by domestic clients to companies related to obligations in contracts for the provision of digital goods and/or services in connection with the company's main business; d) Branches or representatives of domestic companies that offer functions such as marketing or consulting for domestic clients and are closely related to the company's main business (located overseas); e) Relationships with domestic consumers that exceed the time limit of 6 (six) months, are not limited to physical presence but include relationships through the sale of goods and/or services; f) Sales of goods and/or services to local consumers that involve close relationships with consumers, for example through the provision of web pages using local languages, providing delivery through local suppliers, providing banking services or other facilities from local suppliers, or providing goods and/or

¹⁹ *Ibid*, p. 135-148.

services from local suppliers; g) Provision of goods and/or services into the country through the collection of data and information provided by domestic users; h) Domestic sales have exceeded a certain amount (threshold); and i) The foreign company sends information (bytes) to the destination country, one of which can be translated into bandwidth usage.²⁰

To impose taxes from these foreign digital companies, authority cannot treat this with the current tax regime. This becomes a particular concern, not only in Indonesia. In effort to set up a new rule to find international consensus, the OECD is currently facilitating forum to discuss and addressing this issue with model and method of profit sharing that can be found on Pillar 1 of BEPS report. The pillar has influenced Indonesia to adopt significant economic presence to impose taxes from foreign digital companies which do not have physical presence in Indonesia and to avoid double taxation and to broaden the definition of permanent establishment by adding digital permanent establishment in digital economy.²¹

1.4 Digital Tax Objects

The complexity of the digital service tax problem is not only caused by the difficulty of defining what a digital service product is, but also due to the complexity of matters involving the collection and use of customer data, which according to countries supporting the digital service tax, user and customer data of the digital service itself has value. It is undeniable that digital companies such as Google, Facebook, Amazon and Netflix use user data to obtain funding and generate revenue from digital advertising and data licensing. For example, in the case of data licensing, user activity when using the digital service product is analysed which is then used to bring in advertisers on their platform. Facebook and Google use this business model as one of their sources of income. OECD in 2018 in its report stated that companies engaged in digital advertising have specific characteristics such as: (i) direct (real-time) measurement of advertising effectiveness based on user interaction (advertising objectives); (ii) ad rate adjustments based on user interaction (advertising target) or similar to prime time in television commercials; (iii) the use of intangible assets in the form of social media platforms, algorithms for placing advertisements that match the advertising objectives, and auction platforms for determining advertising prices (for customers who will place advertisements on these social media).²²

However, there are challenges in determining the tax object if the company providing digital service products is outside the jurisdiction of the tax collecting country. There is a difference in the company's revenue from advertising results and the number of users of their service products, making countries try to impose additional value elements from user data used by digital companies. Countries that support taxes on digital service products consider the data mined by digital companies such as Google, Facebook, Amazon and Netflix has its own value. India implements a special tax on digital companies called Equalization Levy, which was adopted from the OECD BEPS Action 1 recommendation of the same name. This method is used by the Indian government to collect taxes from digital companies on the gross value of digital advertising transaction payments to non-residents.

Apart from digital advertising and data usage, digital companies also have a retail-like business model like the conventional business model. In contrast to companies engaged in conventional retail, retail companies that use the internet as their platform to sell their goods. These type of digital companies have a wider range of customers and are not limited to the area in which they operate.

²⁰ *Ibid*, p. 135-148.

²¹ Syamsul Arifin, *Op Cit.*, p. 5.

²² Herlina Utamawati and Suparna Wijaya, *Op Cit.*

Therefore, companies such as Amazon, Lazada, Shopee and Alibaba have different end consumers with the region in which they operate. In addition to selling their goods on the internet, companies operating in online marketplaces have a business model that allows them to earn income from the use of their user data for advertising and other service costs such as special services offered to sellers to attract consumers. The OECD in 2018 in its report gives special characteristics to digital companies engaged in this field, such as: (i) a wide range of suppliers and buyers (global, not affected by geographical boundaries); (ii) does not have a physical store, only has a factory and/or warehouse; (iii) the ability to perform real-time analysis of consumer behaviour for the purpose of advertising and determining selling prices.²³

In 2017 the European Commission published a digital economic taxation policy guide adopted from the OECD in BEPS Action 1 in the form of imposing an equalization tax on the business circulation of digital companies or withholding tax on digital transactions. In 2017, Italy imposed a tax on digital transactions known as Levy on Digital Transactions (LDT) for online retail companies based in Italy and abroad. The Italian government imposes an LDT tax of 3 percent on each type of certain transactions, whether carried out by end consumers, such as business to business or B2B transactions.

The development of internet technology has also disrupted transportation services. This can be seen from the many online transportation sharing services such as Gojek, Grab, Uber, Maxim and lyft. Digital service products offered by online transportation service providers are not limited to commissions from passenger payments for each driving transaction, but also from derivative business lines such as delivery of goods and/or food. Similar to other digital businesses, user data is one of the differentiating factors in the online transportation business. Online transportation service providers also have a business model that allows them to earn income from the use of user data using their applications. OCED in 2018 identified the characteristics of companies providing online transportation services: such as: i) a broad base of drivers and passengers (global, not influenced by geographic boundaries); (ii) pricing based on computer algorithms (demand and supply); (iii) the ability to analyze the behavior of passengers and drivers in real-time for the purpose of improving services or for use by other parties (other sources of income).²⁴ Several countries, including Indonesia, have begun to regulate the imposition of specific taxes on business models developed by online transportation providers. In the United States, drivers are required to fill out a general tax form consisting of income earned from transportation sharing services and expenses incurred.²⁵ Canada collects taxes on every transaction in online transportation by using the term operation fee or city fee by charging passengers a tax fee which is then deposited by an online transportation service provider company.

In Indonesia, the definition of intangible good can be found on Law Value Added Tax. On the new VAT subject regulation, goods that can be categorized as digital goods are like, ebooks, apps, games, music, film, software and digital services that provide services like video conferencing and web hosting. According to Regulation No. 12/2020 by the MOF Directorate General of Taxes (DGT), businesses will be appointed as VAT collectors if the transaction value with their customers in Indonesia exceed IDR 600 million (USD 42,000) in a year or IDR 50 million (USD 3,500) in a month, or if 12,000 users visit their e-commerce platform from Indonesia in 12 months, or one thousand users in one month.²⁶ Furthermore, if intangible goods and services from outside Indonesia jurisdiction are traded in

²³ *Ibid.*

²⁴ *Ibid.*

²⁵ *Ibid.*

²⁶ Syamsul Arifin, *Op.Cit.*, p. 6.

Indonesia jurisdiction through e-commerce, individual or entity that sell this goods or services through ecommerce will be appointed by the Ministry of Finance as a VAT collector.

2. Digital Tax Consensus

2.1 International Taxation System

Taxation is something that cannot be separated from the state sovereignty. Tax sovereignty refers to the power of the state to impose taxes on every resident living in its territory.²⁷ In return, state provides facilities and services to its residents. However, the rise of digital economy poses a new threat to tax sovereignty cause international taxation system nowadays limited by jurisdiction. One of the advantages from digital companies from this new business model is they can operate without having any physical presence in the market country.

Digital service products are difficult to measure accurately, this makes the problem of digital tax is very complex. The complexity problem on taxing of digital product is not only caused by the difficulty of policy makers in defining what a digital service product is, but also because of the complexity on involving the collection and use of customer data, which, according to countries supporting digital services tax, data on users and subscribers of such digital services. In other words, this digital economy era is placing a new threat to international taxation system to impose tax from digital companies that do not have physical presence in the market jurisdiction.

The proponents of digital services tax argue that the data generated by users of digital service platforms has financial value even though the service is free. It is because the platform providers make a profit from the user data. One of the reasons for the difficulty of taxing these companies is that their presence in a country is completely intangible and can operate in a country without having to be physically present. For example, in Indonesia, these digital companies are not part of the taxation object because they do not have a physical office or physical tax object in the country. In fact, these companies enjoy income from Indonesian residents who use their services. This has become the basis for countries such as Indonesia, France and India to start imposing tax payers on digital companies such as Netflix and Google. However, the home of Big-Tech companies, the United States has threatened to impose 100 percent tariff on France, Indonesia, India and European Union members goods following tax on tech giants. This comes down the European Union to delay its new digital service tax.

In general, there are two agreements that serve as references for various tax issues, especially cross-border taxes. The first is the United Nations Model Double Taxation Convention between Developed and Developing Countries by the United Nations (UN) and the second is the International VAT/GST Guidelines and the Tax Convention on Income and on Capital by the Organization for Economic Co-Operation and Development (OECD).²⁸ In the guidelines made by the OECD, there are provisions governing VAT as a consumption tax regarding the neutrality of VAT in the context of cross-border transactions, it is determining the place owed in transactions of services and intangible goods as well as various supporting guidelines on minimizing disputes, mutually beneficial cooperation and implementation in the case of tax evasion.²⁹

However, the requirements related to Permanent Business Entities become biased when it faces the activities of digital companies nowadays. As stated above, one of main problem to tax digital companies such as Google, Facebook or Sportify is there is no clear of their physical presence where

²⁷ Christian Oliver Lucas-Mas and, Raúl Félix Junquera-Varela, *Op. Cit.*

²⁸ Rachmad Utomo, "Tantangan Pengawasan PPN atas Transaksi Konten Digital", *Jurnal Pajak Indonesia*, Vol. 1, No. 1, 2017, p. 1-6.

²⁹ *Ibid*, p. 1-6

these companies conduct or run their economy activities. The absence of physical presence of their activities makes it difficult for government to tax these companies. Based on this argument, many digital companies refuse to pay taxes because they think they are not part of tax subject of permanent business entities. Based on this argument, the international community considers that conventional tax regulations are considered no longer relevant.

In April 2020, the OECD/G20 Task Force on The Digital Economy (TFDE) conducted a digital tax discussion that focused on two subjects. First, the taxation of income is generated from digital activities allocated in each relevant jurisdiction, where taxation rights must consider the amount of user participation, intangible assets related to marketing functions and the existence of significant economic activities. Second, the development of regulations related to the set of rules for the imposition of minimum tax rates that can be applied globally and other issues related to tax avoidance.

2.2 Permanent Establishment.

The concept of permanent establishment widely used since the League of Nations tried to develop and define this concept after First World War. Historically, the original concept of permanent establishment can be traced back in Prussian German Empire. Initially, the objective of this idea was to prevent double taxation between Prussian municipal. The definition of permanent establishment emerged in German Double Taxation Act of 1909 to prevent double taxation between German States.³⁰

The growing of digital business makes taxation system has to adapt and evolve to this new economy. The legal nature of permanent establishment which has become the foundation and well-established in international tax system has to adapt with this new economy system. This is why the definition of permanent establishment is still continually evolving.

Before digital economy becomes a thing, permanent establishment has always been linked and related to physical presence. However, this rise of internet makes this concept to adapt and evolve beyond physical presence. Digital companies are able to doing their business activities and generate revenues without having any physical presence on their destination countries. These digital companies then shift their revenue back to countries where they are resident. Unfortunately, even all of these digital companies often escape to paying tax from revenue they can generate in the destination countries. This situation results frustration and rise debate in international forum to reform international tax rule that can provide taxation systems to impose foreign digital companies without having physical presence on their destination countries. In other words, digitalization is transforming and redefining the international taxation system, including the definition of permanent establishment.

To alignment taxation systems, there must be international consensus about digital tax systems to meet. On the 2015 BEPS Action report, OECD highlights that the concept of permanent establishment should be evolving beyond the current definition. The ability of digital companies to operate without having physical presence on their destination countries has raise frustration in many countries. To impose taxes from digital companies which generate revenue oh their jurisdiction, many countries have introduced digital services taxes, including the large number of European Union members like Italy and France. On article 5 (4) of the OECD Model Convention about permanent establishment, there is an exemption for a number of business activities even if their activity is carried on through a fixed place of business.³¹

³⁰Benjamin Walker, "The evolution of the Agency Permanent Establishment Concept", (n.d.), available at <https://www.business.unsw.edu.au/About-Site/Schools-Site/Taxation-Business-Law-Site/Documents/40-Walker-ATTA2018.pdf>,

³¹ Wallace Cheng and Clara Brandi, *Op. Cit.*

3. Digital Tax in Indonesia

Similar to other countries, digital tax is a new area that has not been maximized by the Indonesian government. The huge potential of Indonesia's digital economy has made the Indonesian government try to regulate this sector. But since internet penetrates Indonesia, the Indonesian government has not been able to addressing laws and regulations specifically capable of regulating the digital economy in Indonesia.

Indonesia regulates digital taxation in circulate letter (SE) which regulates the Affirmation of Tax Provisions on eCommerce Transactions, namely SE/62/PJ/2013. The circular letter issued by the Director General of Taxes Number SE/62/PJ/2013 stated that there is no difference in tax treatment between the digital economy business model and other conventional business transactions. Therefore, e-commerce income tax regulations still follow the current regulation that regulate tax in Indonesia. Unfortunately that regulation failed to accommodate digital companies that do not have physical presence in Indonesia jurisdiction.

PMSE regulated in Indonesia based on Law of the Republic of Indonesia Number 7 of 2014 about Trade. However, this regulation only regulates the completeness of data and information for business actors that use electronic systems and sanctions if they do not match the data and information. This regulation do not touch taxation to digital companies that operate their business without having physical presence in Indonesia. The Indonesian government realized the huge potential and income from this sector, then tried to regulate taxation systems from digital transactions based on PMK No 210/PMK.010/2018. However, as I mentioned above, the unclear situation and the failure of WTO members to make a new regime for taxation systems for digital companies makes Indonesia government revoked the regulation.

The current global pandemic makes Indonesia government to adapt and But in 2020, Indonesia Government decided to enact Law No. 2/2020 that aims to impose income tax that come from on electronic systems transactions from foreign digital companies with a 'significant economic presence' which do not have physical presence in Indonesia.

Based on this regulation, digital companies that makes profit from significant presence in Indonesia that passes certain threshold will be defined as Permanent Establishment and that makes all those companies liable to paying Corporate Income Tax (CIT).³² However, there is inconsistency between GR 80/2019 and Law 2/2020 which may cause uncertainty in the market.³³ Law 2/2020 stated that digital companies does not need physical presence as a requirement for digital companies (PPMSE) like Facebook, Google and Netflix to be taxed in Indonesia jurisdiction. However, the inconsistency can be found in GR 80/2019 that stated foreign PPMSE to set up their office or representative in Indonesia. The GR outlined a threshold of a minimum of 1,000 transactions per year,³⁴ which does not arrange in line with Law 2/2020 based on on the sales amount and not the number of transactions.³⁵

Based on Law 2/2020, Indonesia Government gives permission to the Directorate General of Taxes (DJP) to tax digital companies that do not have a representative office in Indonesia but have a significant economic presence as a Permanent Establishment. This regulation allows Indonesia Government to impose taxes on cross-border business profits from these companies. Furthermore, this law is an umbrella regulation to introduce Value Added Tax on intangible digital products services from

³²Syamsul Arifin, *Op.Cit.*, p. 4.

³³*Ibid.*

³⁴*Ibid.*

³⁵*Ibid.*

foreign digital companies outside Indonesia jurisdiction that are traded through electronic transmission (PMSE). Digital goods or product that part of this subject are digital products like software, music, e-book and all electronic data including digital services product that provide product like webhosting, video and other services.³⁶

This regulation allows Indonesia government to impose tax from digital companies which are not registered or do not have any physical presence in Indonesia so it can be taxed from their revenue which they generated in Indonesia. Furthermore, this Law allows Indonesia government imposes an Electronic Transaction Tax (ETT) on direct sales or sales through the marketplace.³⁷

Digital companies that have significant economic presence in Indonesia will be forced to pay their tax that come from revenue which they generated in Indonesia. A portion of income tax that they should be paid to the company's home jurisdiction, will be attributable to the authorities in Indonesia, where the products and services are marketed.³⁸ However, the lack of alignment between relevant authorities will make the home of Big-Tech companies will disagree. the new tax regime that Indonesia enacts would affect tax revenues of the home of jurisdiction of the Big tech foreign companies. Indonesia is a party of 33 double tax agreements, if they find this regulation violate tax treaty and agreement, countries that have agreements with Indonesia will consider Indonesia violate the treaty and the agreements.

Furthermore, Indonesia need regulation to integrate digital taxation regime to accommodate and to impose foreign digital companies which generate revenue in Indonesia.

IV. CONCLUSION

It is undeniable, the huge potential of the digital economy is able to open up opportunities for digital service product companies to get consumers outside the country's borders. However, the definition of digital service products must be resolved to impose taxes to foreign digital companies which do not have physical presence on their destination countries. The current international tax regime are not considered relevant anymore. That's why the author believes the imposition of taxes on digital businesses requires a global agreement. To adapt this a new economy era, taxation regulation must be evolved to the way business has changed over the last decades. In particular, the rise of digital business should be the way to expand the international tax regime to impose taxes from foreign digital companies which do not have physical presence but having significant economy presence in destination countries.

In the context of the digital economy, the boundaries of the digital world are blurred, but this cannot be used as an excuse for multinational companies engaged in the digital economy sector to avoid collecting taxes on income from economic activities they generate outside the countries they operate in. The concept of permanent establishment which has been used and core in many tax-related regulations is considered no longer relevant in the context of the digital economy. The alternative proposed by the OECD which is summarized in BEPS Action 1 and the Interim Report should be used as a temporary alternative solution for policy makers until a global consensus is reached regarding tax collection of digital service products. Furthermore, the new international tax regime must be able to interpret and expand the definition of permanent establishment beyond the border. Moreover, the significant economic presence is a new concept that must be develop beyond the definition of the permanent establishment to create a new nexus for non-resident digital companies. So, it will accommodate the

³⁶ *Ibid.*

³⁷ *Ibid.*

³⁸ *Ibid.*

jurisdiction country where they are part of resident and the jurisdiction where this entity generate revenue.

As a destination country, Indonesia must be able to set a new tax regime to accommodate this economic system to impose foreign digital companies like Netflix, Google, Facebook and other foreign digital companies which do not have physical presence but having significant economic presence in Indonesia.

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