

Literature Review on Digital Service Tax as Reference for New Business Model in Indonesia

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Abstract—Technological development is one of the triggering factors of market globalization and production globalization. Market globalization has made the national market into a global market unit called international trade. The presence of the internet in international trade has led to the emergence of digital goods and services transactions. The challenge in this digital transaction relates to the imposition of tax. Digital transactions can be transactions between countries that involve international taxes. Digital transactions do not require the existence of economic substance (permanent establishment) to conduct transactions. At present the Organization for Economic and Cooperation Development (OECD) is developing regulations on taxation of digital transactions. This is done to prevent tax fraud committed by multinational web based firms. The Indonesian government has issued Regulation of the Minister of Finance of the Republic of Indonesia Number 210 / PMK.010 / 2018 which regulates the tax treatment of trade transactions through electronic systems (e-commerce). It was revoked before it became effective because of the pros and cons of its imposition. The purpose of this study is to examine the taxation rules for digital transactions in other countries and analyze the use of these rules as a reference in Indonesia. The results showed that several countries have developed regulations related to taxation of digital transactions that apply in their respective countries. Most include taxes on digital transactions in the Value Added Tax (VAT) object. But not a few countries also include these taxes in the Good and Service Tax (GAT).

Keywords—international trade, digital tax, web tax, and international tax

I. INTRODUCTION

The development of technology has eliminated borders between countries that cause changes in a country's trade. Initially, trade only occurred nationally in the country. After the development of technology or the emergence of the internet, the national market has merged into a global market. In the era of innovation, global business is becoming increasingly digital. This condition forces fiscal policy makers to take action related to taxation of transactions that occur.

Digital economy is the transaction of goods and services through internet media (e-commerce). The digital economy has

made it easy to exchange information, buy and sell transactions, and make payment transactions more accessible for many people. This is the main attraction of the digital economy, which is increasingly developing, especially in Indonesia. In Indonesia, there are four types of e-commerce namely online marketplaces, classified ads, daily deals, and online retails. The most commonly used type of e-commerce is online marketplaces such as Tokopedia. Digital businesses also use social media like Facebook and Instagram to sell their goods and services. In addition, they also use Google as a means of advertising.

In 2018, Indonesia is the fastest growing e-commerce country. Even Indonesia has defeated Vietnam and the Philippines in the ASEAN region. Based on the data below, the number of internet users in Indonesia is more than 100 million users. It is one of the drivers of e-commerce growth. Most of the Indonesian people spend their money on online shopping sites, hotel reservations, and plane tickets. See figure 1 below.

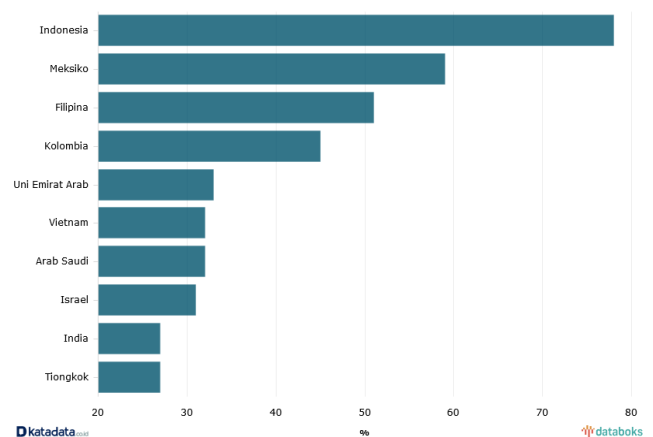


Fig. 1. Ten countries with the fastest growing e-commerce.

There are six of the most visited e-commerce sites in Indonesia. The e-commerce includes Tokopedia, Buka Lapak, Lazada, Shopee, JD ID, and Bibli. Each e-commerce players

try to attract buyers with various discounts. Following are data on average visits per month in 2018. It can be seen on figure 2.

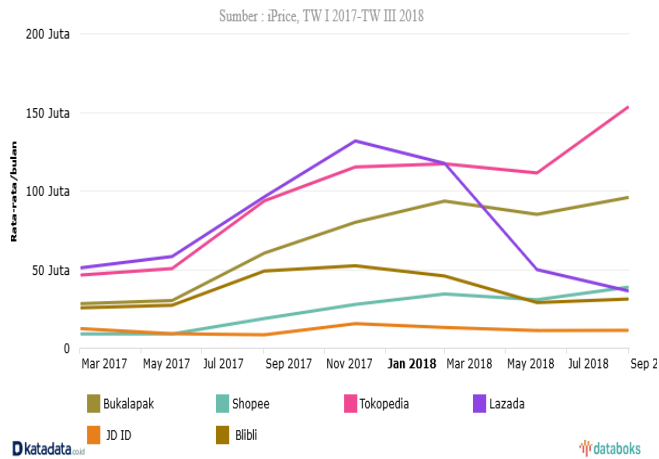


Fig. 2. The most visited e-commerce in Indonesia.

The convenience that e-commerce provides for business people is that e-commerce transactions do not require physical or permanent forms of business. As a result, taxation authorities experience difficulties in taxing digital transactions. Problems become more complex when business transactions occur between countries. Taxation of these transactions was included in the international tax area.

International tax is a term that refers to the international aspects of each country's tax provisions. These provisions basically govern two things. First, taxation of income received by domestic tax subjects from sources outside the country. Second, taxation of income received by foreign tax subjects from within the country [1]. For example, Indonesia can tax the income derived by foreign tax subjects from domestic tax subjects (residents of Indonesia). In addition, Indonesia can tax the income obtained by domestic tax subjects (Indonesian residents) from foreign tax subjects. In the case that an overseas subject in the form of a foreign company has a Permanent Establishment in Indonesia, then taxation will be carried out on the income obtained by the Permanent Establishment. If there is no PE in Indonesia, the tax authority cannot tax the income obtained by a foreign company.

Some time ago, Google was entangled in taxation problems in Indonesia. Google Indonesia was indicated to have violated tax obligations. This violation was caused because Google Indonesia does not yet have a Permanent Establishment (PE). In other words, it has not become a taxpayer. In Indonesia, Google only has a representative office and not a permanent office. Based on the definition of Permanent Establishment, a Google representative cannot be categorized as a PE as a Tax Subject under the Income Tax Act. Thus, Google Indonesia is considered to have no tax obligations. In addition, Google Indonesia has never cut VAT or PPh. Though the advertising business transactions in the digital world in 2015 reached \$ 850 million. Indonesia was not the only country that was eyeing

Google regarding its tax obligations, namely France, Britain and Italy. Besides Google, the giant digital companies that were also experiencing the same thing are Yahoo, Facebook, and Twitter.

As global business becomes increasingly digital, the role of government as policy maker is needed to explore new digital taxing policies. This new policy must identify problems related to "what", "when", "where", "how", and "by whom" taxation of digital transactions is carried out. Currently, several countries and groups of countries are trying to develop new policies for digital transactions in the future.

This research is expected to contribute to the literature in several important ways. First, it extends our understanding about digital taxation. Second, we study how other countries taxing digital transactions from web based firm that earn some earning in their countries. Third, it can give us suggestion about how we can tax digital transaction in Indonesia. Then, we try to adopt the policy as reference for taxing of digital transactions in Indonesia.

Rest of the paper is organized as follows, Section I contains explanation of taxing problems that countries facing in the digital era. In Section II, we review digital tax policy in other countries and describes the previous research works. In Section III, we explain the methodology which we use. Section IV contain the result and discussion about important findings. Section V explain the main conclusion, discuss the limitation of the research, and future scope.

II. RELATED WORK

Research related to digital service tax has been conducted by Zeng et al. [2] They studied about e-commerce tax collection and administration in China. They found that there were many problems tax collection on e-commerce in China. Not only tax collection but also administration related to e-commerce. The problems were legal systems, assess tax base, uncertainty of tax object, etc. Their research tries to give several developing strategies from the laws and regulated related to e-commerce taxation, administration model for tax, international e-commerce standard, and the information related to tax collection and administration [2].

Yapar et al. [3] studied about the role of taxation problems on the development of e-commerce. They focused on how e-commerce could be developed with proper tax regulations. In their research, they founded development of e-commerce and factors that influenced e-commerce growth was examined. Purchasing and sale over internet without any borders country could make taxation problems. Such as, the difficulties in determined which country had rights of taxation, non-taxation can occur because there was no physical presence, varied tax policy and tax rate, and double taxation risk. Countries have not found any certain solution yet. If an agreement has been made to solve taxation problems, so more business and consumer will enter e-commerce marketplace. Thus, countries will be not enduring tax revenue loss because untaxable e-commerce transactions [3].

III. METHODOLOGY

This research was undertaken through a qualitative approach to examine the taxation rules for digital transactions in other countries. The next purpose is analyzing the use of these rules as a reference in Indonesia. The research use literature review of previous studies about taxing digital or e-commerce transaction. Research process analysis is done through four stages, that is data collection, data reduction, data presentation, and withdrawal conclusion.

IV. RESULTS AND DISCUSSION

Digital transformation gives us innovation, efficiencies, and improve services. At the same time, this change introduce challenge in many ways, including taxation. E-commerce have forced policy maker facing some questions. Do technology should adapt to meet the needs of the government or government should reform their technology to the new mean of technology? Several specific issues related to taxation such as the digital economy grows in size and complexity.

First, loss of tax revenue. Digitalization of business operations can create Base Erosion and Profit Shifting and create double non-taxation and reallocation of taxable income. The MNC can try to avoid tax liabilities. They can be placing server in the host country with lower or no tax rate rather than the home country. So there is tax revenue loss. Second, loss of tax objects. For now, international tax rules allow the source country to tax the nonresident's business profits only if there is presence such as permanent establishment, whether it is substantial physical presence or just a dependent agent. Thus, if there is no physical presence, then it cannot be taxed. Third, unclear income characterization. Digitalization make income characterization become complex. It will be heavy to determine type of income, mainly royalty, service fee, and business profit. In e-commerce transaction, we cannot distinguish the type of income. Fourth, ineffective VAT. Digitalization create issues of VAT collection, especially business to consumer (B2C) and customer to customer (C2C). VAT collection on service and intangible transaction will be difficult. Moreover, the transactions are cross border transactions. C2C transaction in e-commerce, where the suppliers are individuals and/ or households. The existing VAT systems does not include a specific registration and collection for individual suppliers [4].

Tax challenge of the digitalization of business were identified as one of the main areas of focus on BEPS project, leading to the 2015 BEPS Action 1 Report. For indirect taxes, OECD BEPS Action 1 Report recognize new challenges related to the collection of Value Added Tax (VAT) or Goods and Services Tax (GST) on online purchases from foreign suppliers. As for direct taxes, Action Report 1 observes that digitization could not only cause BEPS problems, but also pose a broader set of tax challenges. This challenge is related to the question of how the right to tax income generated from cross-border activities in the digital era [5].

In January 2019, OECD/ G20 Inclusive Framework on BEPS issued a short Policy Note. The Note will have grouped

the proposals into two pillars. Pillar One, focuses on the allocation of taxing right and looks for to undertake a correct review of the profit allocation and nexus rule. Pillar two is concerned about remaining BEPS issues. In order to reaching a consensus solution to Pillar One issues, the Secretariat of OECD/ G20 prepared a proposed "Unified Approach". The Public Consultation meeting to discuss the proposal will be held on November 2019. The objective is to provide external stakeholders an opportunity to provide input into the ongoing work.

There are several alternatives set out in Pillar One. First, all proposals will reallocate the right of taxation for the benefit of the jurisdiction of the user / market. Secondly, all the proposals envisage a new nexus of rules that will not rely on the physical presence in the jurisdiction of the user / market. Third, they are all beyond arm's length principle and departing from the principle of a separate entity. Fourth, they look for simplicity, the stabilization of the tax system, and increase tax certainty in their implementation [6].

Basu said that no matter which entity can controls all activity on the internet. It's there and it's impossible to "off". So, we cannot stop economy activities that occur in the internet. The Internet have three main components. First physical infrastructure as big data such as server, cable, satellite. Second, infrastructure service provided by Internet Service Provider (ISP) that offers access to the internet. Third, legal component which affect the conduct of those business engaged in and influenced by e-commerce [7].

According to the OECD Commentary, placing a server in the source country can already be considered as a physical presence. Physical presence is a basic requirement for PE. If there is PE, the source country can tax. However, if the server is not located in the source country (in other words there is no physical presence), then they do not have taxation rights over digital transactions that occur [8].

One of the goals of the OECD BEPS project was to prevent tax avoidance by multinational companies. Tax avoidance can occur in e-commerce transactions by utilizing the definition of Permanent Establishment (PE). This can happen because international tax principles cannot keep up with the development of new business models and technologies. The old principle of taxing, especially on the income of domestic taxpayers from digital economic activities in the source country.

Permanent Establishment (PE) have important role related taxing of profit company that doing international trading. Company profits only can be taxing in domicile country, except there are close relation with the country where profits generated (source country). The close relationship is in the form of the presence of PE as a company tool in carrying out its business activities in the source country. Discussion about PE is very important because one focus of attention in the BEPS project.

Inclusive Framework on BEPS (IF BEPS) issued Interim Report 2018. This report discusses the latest developments in the world of digital taxation. In general, this report only repeats the results of the previous report and has not provided a solution to the problem of digital taxation. The Interim Report focuses more on unilateral actions, from modifying Permanent Business Forms (PE), withholding tax mechanisms, final tax collection, to special regulations for multinational companies in the digital field. In addition, the Interim Report conducts a search for domestic policies implemented in various countries grouped into four groups. First, policy that seek to change the threshold of a permanent establishment. Second, unilateral action with withholding tax mechanism. For example, extend coverage of deductions and tax collection on royalties. Third, country groups which taxing with equalization levy such as India. Fourth, country which have special regulation with target big multinational company such as Diverted Tax in England.

In China, the rapid development and practical application of e-commerce led to a loss of income tax in the electronic commerce. The condition was judged to be a major challenge for the development of e-commerce and tax collection nationwide. The key point to solve the problem of e-commerce tax loss is overcoming the challenge of information asymmetry. Asymmetry of information on tax-related information from third parties, i.e. banks, customs and finance ministries, and the online intermediary platform. Attempts to overcome this problem can be done in two aspects, namely policies and new internet technologies [9].

The tax imposition plan is not going smoothly. The Commission and OECD which are currently studied this plan, have different views. So that each country began taxing by using a unilateral tax policy.

In March 2018, the European Commission (EU) have issued two proposals. The first is described as an 3% Digital Services Tax (DST). This tax would apply to revenue from the activities, such as

- The placing a digital interface of advertising
- Third parties who facilitate supply goods and services directly between users, include third parties who facilitate one user with another user to interact
- The transmission which collect user's data and data that generated from user's activities on digital interfaces.

The taxable subjects of this type of tax are companies with total annual revenues worldwide of € 750 million or more and which have annual taxable income of € 50 million or more.

The second proposal is longer term proposal offer. This proposal explains a Significant Digital Presence (SDP) concept as new digital permanent establishment definition. This intended to establish tax nexus, along with revised profit allocation rules to determine how the taxes on digitally [10].

Some countries try the first proposal, so they can be taxing tax profits generated by digital business. Italy have issued web

tax legislation in 2018 but it never came into force. Then the government agree that web tax will come into force in 2020. This type of tax will target digital companies with total assets of > \$ 827 million and profits > \$ 6.1 million. France has also done the same thing, which is a web tax of 3% and will take effect in 2020. In China, The People's Republic of China (PRC) has imposed a Value Added Tax (VAT) of 5% on e-commerce transactions. VAT replace business tax across the service industry. Implementation e-commerce tax in India use other type of levies other than income tax. They apply Equalization Levy Rules (ELQ) scheme. The ELQ scheme applies to the payment of a domestic tax subject to foreign tax subject that exceeds a certain threshold. The UK has issued regulations regarding Diverted Profit Tax (DPT) to tackle the potential loss of tax on digital transactions.

Based on second proposal, a company will have considered to have significant digital presence (SDP) if they meet any one of three criteria. First, the entity has €7 million in annual revenues from digital services in EU member state. Second, the entity has more than 100.000 users who access digital services in a member state in tax year. Third, the entity signs more than 3.000 business contracts for digital services in a member state in tax year.

In Indonesia, there are currently no regulations specifically regarding e-commerce transactions. There is only a circular of the director general of taxes, namely SE/62/PJ/2013 concerning the affirmation of taxation provisions for e-commerce transactions. In other words, the regulation only discusses aspects of taxation without regulating withholding tax of e-commerce. While related to withholding tax, it still uses income tax and value added tax laws. Just like other countries, Indonesia still cannot explain the concept of permanent establishment in terms of e-commerce transactions. The concept of PE in Indonesia still refers to the existing definition in the income tax law. There is no specific definition of a permanent establishment in the context of the digital economy. The problem is the difficulty in collecting VAT that arises from trade between countries in the form of intangible goods and services [11].

Indonesia has implemented 10% Value Added Tax to the price of goods purchased by online. It will cover some type of platforms, such as marketplaces, classified ads, daily deals, and online retails. In 2018, Indonesia issued Regulation of the Indonesian Republic Minister of Finance Number 210/PMK.010/2018 which regulates the tax treatment of trade transactions through electronic systems (e-commerce). Actually, this regulation will force in 2019, but there are pros and cons in implementation so it canceled. Some party think that this is new regulation. In fact, this regulation only reinforces the previous regulations related to Value Added Tax (VAT) and Customs.

V. CONCLUSION AND RECOMMENDATION

Permanent Establishment (PE) have important role in the international trading. Company profits only can be taxing in

domicile country, except the company have permanent establishment in the country where profits generated (source country). For now, there are still no global regulations governing taxation on e-commerce. Existing regulations are still in the form of individual policies based on proposals from the EU or world policy bodies such as the OECD. This happens because there are still differences of opinion regarding the taxation rights on income derived from e-commerce transactions. Each country that has an interest in taxing e-commerce transactions seeks to determine taxes on digital transactions based on proposals from the EU. The current definition of e-commerce according OECD/G20 is still in the form proposal. The proposal is in the stage of requesting public opinion.

The limitation in this study is that there is no global consensus regarding taxes on e-commerce. The OECD / G20 is still conducting public consultations on work programs to build consensus solutions to the tax challenges that arise from digital transactions. Therefore, it is still difficult to find previous literature or research that addresses e-commerce tax.

For further research, it is recommended to discuss the taxation aspects related to e-commerce transactions after the public consultation has been carried out. Thus, a global consensus has been generated and countries already have their respective regulations regarding e-commerce transactions. Further research can discuss the application of tax cuts on e-commerce in Indonesia and other countries.

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