

Is Value Added Tax an Appropriate Solution for Taxing the Digital Economy? (Indonesian Context)

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Abstract

This study explores the appropriateness of using VAT to tax the digital economy in Indonesia, concentrating on the issues highlighted in the OECD's BEPS Action 1 report. Among the key challenges are the exemptions for low-value imports and remote digital services. The paper assesses these issues to gauge the effectiveness of VAT in addressing the taxation of Indonesia's digital economy. The study adopts a qualitative research methodology, utilizing OECD guidelines, Indonesian tax law, policy papers, and scholarly works to analyze the relevant tax challenges. Additionally, it considers VAT as both an alternative and a potential future supplement to Pillar One in the Indonesian context. The findings indicate that while Indonesia's VAT framework tackles certain digital economy challenges, concerns such as collection costs, system complexity, fairness, legal certainty, compliance, and enforcement persist. VAT is viewed as a practical temporary solution and a prospective complement to direct taxes under Pillar One, particularly in addressing gaps not covered by Amount A.

Keywords Value Added Tax, Digital economy, International Tax, BEPS Action 1, Pillar One, Amount A,

1 INTRODUCTION

Indonesia is regarded as a nation with immense potential in the growing

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digital economy. The 2023 e-Conomy SEA report revealed that Southeast Asia's digital economy reached a valuation of USD 218 billion, with Indonesia contributing USD 82 billion, accounting for 38% of the region's total (Google, Temasek, Bain 2023). This signifies an 8% rise from 2022, and estimates suggest it could surpass USD 360 billion by 2030. Indonesia currently holds the top spot in Southeast Asia's digital economy and is predicted to retain this position moving forward.

In response to this anticipated growth, the Indonesian government enacted regulations in 2020 under Law No. 2/2020 regarding State Financial And The Stability Of The Financial System Policies For The Mitigation Of Coronavirus Disease 2019 (Covid-19) Pandemic and/or To Deal With Threats That Are Potentially Harmful To The National Economy and/or The Stability Of The Financial System to regulate the taxation of digital transactions. This law targets income tax on electronic transactions made by foreign entities with significant economic presence in Indonesia. Additionally, it mandates the collection of Value Added Tax (VAT) on digital goods and services sold by international providers to consumers in Indonesia.

However, despite these regulatory efforts, challenges have arisen, particularly concerning income tax enforcement. One major issue is that Indonesia's current tax treaties are based on physical presence, making it difficult to apply the significant economic presence concept in practice, resulting in mismatches with existing agreements (Hidayat, 2020). To address this gap, Indonesia introduced the Electronic Transaction Tax, incorporating the idea of significant economic presence. Yet, as this tax is not part of existing treaties, it is non-creditable in the foreign company's home country, leading to potential double taxation. Additionally, complications emerge in determining profits derived from Indonesia by foreign companies and how taxing rights should be shared between nations (Rebecca, 2021). In light of these complexities, the Ministry of Finance has chosen to pause the implementation of further income tax regulations and instead focus on VAT as the primary mechanism for taxing digital transactions while awaiting global consensus.

The shift to VAT, however, opens a new research gap: is VAT an effective and appropriate tool for taxing the digital economy, particularly in emerging markets like Indonesia? While VAT is widely used in traditional tax systems, its application to digital services and cross-border



transactions presents unique challenges. The OECD's BEPS Action 1 report identifies two critical issues—exemptions for low-value imports and remote digital services—which continue to affect the effectiveness of VAT in the digital economy. Current literature offers limited analysis of these complexities, especially in relation to Indonesia's approach. This research, therefore, aims to fill this gap by assessing Indonesia's VAT framework in managing these challenges.

Additionally, while Indonesia's VAT system has been effective in generating revenue, collecting 16.9 trillion Rupiah (DDTC, 2023) since its implementation, questions remain about the system's fairness, compliance burdens, and administrative complexity. These issues are particularly relevant in light of ongoing global discussions about Pillar One and how indirect taxes like VAT may complement or supplement new international tax rules.

Thus, this paper explores the appropriateness of VAT as a tool for taxing the digital economy in Indonesia by evaluating its effectiveness in overcoming the challenges posed by low-value imports and remote digital services. It also considers VAT as an interim solution and a potential future complement to Pillar One, particularly for addressing gaps not covered by Amount A.

This study is grounded in the theoretical principles of fiscal policy and international taxation, with a focus on the OECD's guidelines for taxing cross-border digital transactions. By addressing both the practical and theoretical dimensions of VAT in the digital economy, this paper seeks to contribute to the existing literature and inform policy discussions on the future of digital taxation in Indonesia.

2 LITERATURE REVIEW

2.1. Digital Taxation and VAT in the Digital Economy

The digital economy has created new challenges for taxation, with businesses increasingly able to generate substantial revenue in jurisdictions without a physical presence. Traditional tax systems, which are built around taxing corporations based on physical locations, are ill-suited for this new global economic reality (Christians, 2018). In response, several countries have begun implementing digital taxes such



as the Digital Services Tax (DST), but indirect taxes like Value Added Tax (VAT) have proven to be particularly effective due to their consumption-based nature (Auerbach et al., 2017).

VAT operates on the principle that consumption should be taxed in the location where it occurs. This makes VAT highly adaptable to the challenges of taxing digital goods and services, especially those provided across borders. VAT on digital transactions ensures that governments can capture tax revenue from the consumption of services even if the supplier is located in another jurisdiction. This is particularly crucial for countries like Indonesia, where the digital economy is expanding rapidly (Devereux & Vella, 2018).

The OECD's International VAT/GST Guidelines (2017) play a pivotal role in defining best practices for the application of VAT in the digital economy. These guidelines provide a framework for how countries can levy VAT on cross-border transactions, ensuring neutrality and fairness in tax collection (OECD, 2015). The guidelines recommend the use of the destination principle, which ensures that goods and services are taxed in the country where they are consumed, making it the preferred model for VAT collection in the digital economy (Ebrill et al., 2001).

2.2. VAT Principles: Destination vs. Origin Principle

The debate between the destination principle and the origin principle is central to the application of VAT on cross-border transactions. The destination principle dictates that VAT should be levied where the goods and services are consumed, ensuring that foreign suppliers are subject to the same tax obligations as domestic providers (Ebrill et al., 2001; OECD, 2017). This principle is widely regarded as the most equitable and efficient means of taxing cross-border transactions, as it prevents distortions in trade by ensuring that domestic and foreign businesses face similar tax burdens (Keen & Lockwood, 2010).

On the other hand, the origin principle imposes VAT where goods and services originate, which can incentivize businesses to shift production to lower-tax jurisdictions, creating a race to the bottom in tax rates. The destination principle avoids these pitfalls by focusing on where the consumption occurs, not where the production takes place (OECD,



2015). This approach is particularly relevant in the digital economy, where services can be supplied across borders without the need for physical infrastructure.

In practice, the destination principle has become the global standard for VAT on cross-border transactions, particularly in the digital economy. The OECD's guidelines and the World Trade Organization's rules on taxation both endorse the destination principle as the best means of maintaining fairness and neutrality in international trade (WTO). Indonesia, in its VAT system for digital services, has adopted the destination principle, requiring foreign digital service providers to collect VAT from Indonesian consumers (Minister of Finance Regulation No. 48/2020).

2.3. International Tax Frameworks in the Digital Economy Era

Historically, international tax frameworks have relied heavily on the concept of permanent establishment (PE), where a business must have a physical presence in a country to be subject to taxation. This concept, as outlined in the OECD's Model Tax Convention on Income and Capital (2017), has been the foundation of cross-border tax treaties. However, the digital economy has disrupted this model, as businesses can generate significant income in jurisdictions without establishing a PE (OECD, 2017).

To address this gap, the OECD's Base Erosion and Profit Shifting (BEPS) project introduced new approaches, including the concept of significant economic presence, which allows countries to tax businesses that generate substantial revenue in their jurisdictions without a physical presence. The Pillar One proposal under the BEPS 2.0 framework aims to reallocate taxing rights to market jurisdictions, ensuring that countries can tax large multinational enterprises (MNEs) based on their digital sales, regardless of where the business is physically located (OECD, 2020).

Pillar One, as part of the BEPS 2.0 initiative, is intended to address these concerns by creating a multilateral framework for taxing the digital economy. Pillar One introduces two key components: Amount A, which reallocates profits to market jurisdictions based on digital sales, and



Amount B, which simplifies transfer pricing rules for marketing and distribution activities (OECD, 2020). While this framework represents a significant shift in international tax policy, its implementation has been slow, prompting many countries to rely on unilateral actions, with many countries introducing their own direct digital taxes, such as Digital Service Tax (DST). According to Schön (2017), unilateral measures reflect a growing frustration among governments with the slow pace of international tax reforms. However, these actions have raised concerns about double taxation, trade conflicts, and compliance costs for businesses operating in multiple jurisdictions (Schön, 2017).

Unlike DST, which basically a direct-based tax and require complex profit attribution rules, VAT is a consumption-based tax that can be easily applied to cross-border transactions. Some countries, including Indonesia, currently rely on VAT as an interim solution for taxing digital transactions. Indonesia has adopted this approach by requiring foreign digital service providers to register and remit VAT on sales to Indonesian consumers (MoF Regulation No. 48/2020), ensuring that the country captures revenue from its growing digital market.

2.4. The Challenge of ‘Exemptions for Imports of Low-Value Goods’

The surge in e-commerce has significantly increased the volume of low-value imports. Traditionally, these imports have been exempt from VAT in many jurisdictions, including Indonesia, due to the administrative costs associated with taxing small, cross-border transactions. However, the exemption has led to revenue losses, as businesses exploit this threshold to avoid VAT by breaking up larger shipments into smaller ones, a practice known as "parcel fragmentation" (OECD, 2015).

Indonesia recognized this problem and responded by lowering the tax exemption threshold from USD 75 to USD 3 in 2019 under Minister of Finance Regulation No. 199/PMK.10/2019. By removing the exemption for most low-value imports, Indonesia aims to level the playing field between foreign and domestic suppliers and to capture more VAT revenue. This policy shift aligns with the OECD’s recommendation that countries address the tax gap created by low-value imports (OECD, 2015). However, while the change has been effective in generating



additional revenue, it has also introduced new administrative challenges, as the cost of collecting VAT on such small transactions may outweigh the revenue gained (Brondolo & Konza, 2021).

Critically, the issue of low-value imports reflects broader global concerns about the effectiveness of VAT systems in the digital economy. The volume of small parcels crossing borders has made VAT collection on such imports inefficient for many countries. Although Indonesia's policy reform has addressed some of these challenges, it also highlights the tension between improving tax collection and managing administrative complexity (Directorate General of Customs and Excise, 2020). The effectiveness of Indonesia's approach will depend on further streamlining VAT collection processes, particularly for low-value goods.

2.5. The Challenge of 'Remote Digital Supplies to Consumers'

Unlike physical goods, applying the destination principle to cross-border digital services and intangible products poses significant difficulties (OECD, 2017). The inherent nature of these services makes it impossible to enforce border control measures in the same way, removing the possibility of collecting taxes through traditional border checks.

Moreover, with the expansion of the digital economy, businesses can now provide digital services to consumers across the globe without maintaining any physical presence in the jurisdiction of the consumer (OECD, 2015). According to a UNCTAD report, since 2010, the average growth in the import of digital services across 22 regions has been close to 60% (Brondolo & Konza, 2021).

This development complicates VAT collection, often leading to little or no VAT being levied on such transactions (OECD, 2015). Take, for instance, digital platforms like Steam, which sell virtual items to gamers worldwide. These items are typically accessed on digital devices such as smartphones and computers via the internet. When Steam operates within the same jurisdiction as the consumer, it is required to collect and remit VAT for the digital items sold. However, complications arise when Steam operates outside the consumer's jurisdiction. In such cases,



no VAT may be collected, placing local businesses—who are obligated to collect VAT—at a competitive disadvantage compared to foreign businesses that don't face the same requirement.

To mitigate this issue, the OECD has provided guidelines for collecting VAT on cross-border digital services and intangible products. For B2C transactions, the guidance suggests a vendor-based collection method, which requires foreign suppliers to register, collect, and remit VAT according to the laws of the consumer's country of residence (OECD, 2017). In contrast, for B2B transactions, the OECD recommends the reverse charge mechanism. This approach places the responsibility on resident businesses that purchase services from foreign suppliers, requiring them to account for VAT as though they were the provider (OECD, 2017). In this way, the obligation to collect and remit VAT shifts from the foreign supplier to the local buyer.

3 METHOD, DATA, AND ANALYSIS

This paper uses a qualitative research methodology designed to gather relevant literature as a basis for analyzing the research questions. The primary literature includes OECD guidelines on addressing tax challenges in the digital economy, particularly concerning Value Added Tax. Additionally, the analysis incorporates other sources such as Indonesian domestic tax law, policy papers on related issues, and other scholarly works such as books, journals, and articles, as well as recent news from both print and electronic media.

4 RESULT AND DISCUSSION

4.1. Evaluating Indonesia's VAT Measures on Low-Value Imports

Indonesia has experienced a significant increase in the import of low-value goods, particularly between 2017 and 2019 (DJBC, 2020). By 2019, imports had surged to 49.89 million units, more than double the 19.57 million recorded in 2018 (DJBC, 2020). These goods, valued below the *de minimis* threshold of USD 75, were previously exempt from taxes, including VAT, upon entering Indonesia.

In response to this growing trend, the Ministry of Finance introduced new



regulations in 2019. Through MOF Regulation No. 199/PMK.10/2019, the threshold was drastically lowered from USD 75 to just USD 3. However, while the exemption for import duties remained, VAT at a rate of 11% would now be applied to all goods, regardless of value, effectively removing the VAT exemption entirely.

This regulatory shift aligns with the destination principle of VAT, ensuring that consumption is taxed in the jurisdiction where it occurs (Ebrill et al., 2001; OECD, 2017). Indonesia's implementation of this principle is consistent with the OECD's International VAT/GST Guidelines (OECD, 2017). By enforcing VAT on low-value imports, Indonesia attempts to prevent parcel fragmentation, a practice where larger shipments are split into smaller parcels to avoid VAT, a challenge identified by the OECD (OECD, 2015). This move is also consistent with the global trend of reducing VAT exemptions for low-value imports, as seen in the European Union and Australia, which have adopted similar measures (Brondolo & Konza, 2021).

Moreover, while the removal of VAT exemptions has led to increased revenue collection, the policy has broader economic and social implications. Economically, the removal of the VAT exemption levels the playing field between foreign suppliers and domestic SMEs, which previously faced unfair competition from foreign businesses that benefitted from VAT exemptions.

However, the increased cost of collection, particularly on low-value goods, raises questions about the cost-efficiency of the policy. The rising cost of administering VAT on small-value transactions may reduce net revenue gains, especially when collection costs outweigh the revenue collected. This issue is exacerbated by the absence of a vendor collection model, which would shift the responsibility of VAT collection to foreign sellers, reducing the burden on local intermediaries and tax authorities. This method, endorsed by the OECD, is considered the most efficient way to handle VAT collection on such goods (OECD, 2015).

While the Ministry of Finance has taken steps to streamline the process—most notably through consolidated billing, which allows courier companies to combine VAT and import duties into a single bill—these efforts have had limited impact on reducing collection costs. The policy primarily benefits courier services but does not extend to individual importers or other companies that play a major role in importing low-



value goods.

Currently, Indonesia employs a mixed approach involving both the purchaser and intermediaries. In the purchaser method, buyers are responsible for calculating and paying VAT, but this system often leads to low compliance rates, making it difficult and costly for tax authorities to enforce. The intermediaries method, in contrast, designates local courier companies to collect VAT from foreign sellers and domestic buyers. Although this approach, enhanced by consolidated billing, simplifies payment processing, it can incur additional costs, which are ultimately passed on to the consumer.

On a social level, the removal of VAT exemptions could also have implications for consumers, particularly in terms of price sensitivity. The additional VAT on low-value goods may increase the cost of essential products, particularly for lower-income households, who are more likely to purchase low-cost items online. This could exacerbate income inequality, as the policy effectively makes imported goods less affordable for consumers in the lower-income bracket

In summary, while Indonesia's measures have reduced revenue losses from low-value imports, the broader economic and social implications require further consideration. Adopting a vendor collection model would streamline the process and reduce collection costs, while also ensuring fair competition between foreign and domestic suppliers

4.2. Indonesia's Approach to Tackling VAT on Remote Digital Supplies to Consumers

Since 2020, the Indonesian government has enforced VAT on digital goods and services sold by foreign entities to Indonesian consumers. This policy was first introduced via Minister of Finance Regulation No. 48/2020 and later updated through Minister of Finance Regulation No. 60/2022, with procedural details outlined in Director General of Taxes Regulation No. PER-12/PJ/2020. Rather than employing different VAT collection methods, Indonesia utilizes the vendor collection model for both B2C and B2B transactions.

This model requires foreign businesses selling digital goods or services



in Indonesia must register as VAT collectors if they surpass certain thresholds: annual transactions exceeding 600 million Rupiah, monthly transactions over 50 million Rupiah, or if they have more than 12,000 users per year or 1,000 users per month. Appointed by the Ministry of Finance, these businesses must charge 11% VAT, submit monthly payments to the Indonesian government, and file quarterly reports. This demonstrates Indonesia's adherence to international best practices, aligning with the OECD's VAT/GST Guidelines (OECD, 2017), which advocate for the vendor collection method.

The vendor collection model has proven effective in generating VAT revenue from digital services. By 2023, 163 foreign companies had been designated VAT collectors, including major digital platforms like Amazon, Google, and Netflix. Since 2020, VAT collected from digital services has totaled 16.9 trillion Rupiah, with a 22% increase in receipts between 2022 and 2023.

The system also features a simplified registration process for foreign businesses. Once appointed, they can activate accounts and update information online, with the Indonesian Tax Authority engaging in pre-communication to ensure readiness. The VAT payment and reporting processes are streamlined through an online platform that allows foreign currencies with prior approval. Foreign businesses are only required to file quarterly VAT reports, further simplifying compliance.

However, the approach raises significant questions regarding fairness and legal certainty. For example, the appointment-based registration system introduces fairness concerns. Unlike self-registration systems where companies must register once they meet certain criteria, Indonesia's appointment mechanism means only designated companies have VAT obligations. As a result, some businesses that meet the criteria may not be required to collect VAT, creating an imbalance. This issue wouldn't arise in a self-registration system, as all eligible companies would automatically have VAT obligations, and non-compliant entities could be penalized retroactively. The fairness issue extends to domestic versus foreign companies. While foreign VAT collectors are required to register if their sales exceed 600 million Rupiah, the threshold for domestic companies is 4.8 billion Rupiah. Although this boosts VAT collection, it places an uneven burden on foreign businesses compared to local firms. This disparity may discourage foreign businesses from entering the Indonesian market, potentially limiting foreign direct investment (FDI)



and reducing the competitiveness of Indonesia's digital economy.

Another concern relates to legal certainty during the registration phase. Companies meeting the criteria but not yet appointed as VAT collectors may submit a notification to the Indonesian government, but this is optional. If a business doesn't notify the authorities, it faces no consequences, meaning VAT on its digital sales may go uncollected.

Further, from a comparative perspective, Indonesia's VAT framework, though effective, faces challenges in terms of compliance. Unlike self-registration systems used in countries like Japan, which automatically impose VAT obligations on companies once they meet the criteria, Indonesia's appointment-based system introduces the risk that some qualifying companies may evade tax collection obligations.

In terms of enforcement, foreign VAT collectors are not recognized as taxpayers under Law No. 28/2007, making it difficult to impose penalties for non-compliance. Revising regulations to explicitly define the role of foreign VAT collectors is necessary for future enforcement. Additionally, Law No. 2/2020 mentions penalties like access termination for non-compliance, but the implementation of such sanctions remains unclear. While access termination may be effective, it could trigger consumer backlash, as digital services are now essential in Indonesia.

Indonesia does not face significant issues from the non-application of the reverse charge mechanism in B2B transactions. Foreign VAT collectors provide documentation that allows domestic businesses to claim input tax credits, ensuring businesses can offset VAT on imports used for taxable supplies. Furthermore, domestic businesses that have already paid VAT can seek reimbursement to avoid double taxation.

In conclusion, Indonesia's vendor collection model has been largely successful in addressing VAT on digital services sold to consumers. The approach has significantly increased VAT revenue from cross-border transactions. However, the system faces challenges, including issues around fairness, legal certainty, compliance, and enforcement, which need to be addressed for greater effectiveness.

4.3. VAT: A Present Alternative and a Future Supplement to Pillar One



Indonesia's government introduced unilateral measures to tax digital transactions through Law No. 2/2020, establishing an Electronic Transaction Tax aimed at levying income tax on foreign businesses with significant economic presence in the country. However, as outlined in earlier sections, the Electronic Transaction Tax faces various implementation challenges. Due to these difficulties, the Ministry of Finance decided against further regulations for income tax collection through this method.

As a result, Indonesia has shifted its focus to a single unilateral approach: the implementation of VAT for taxing digital transactions. From the analysis presented, it's evident that VAT has effectively managed the complexities of digital economy taxation in Indonesia, positioning it as a reliable interim solution while awaiting global consensus. This suggests that VAT currently serves as a practical unilateral tool for Indonesia in taxing digital economy transactions.

Two key questions arise: Is VAT a robust alternative for taxing the digital economy in Indonesia? And, if the Pillar One framework is adopted globally, could VAT complement the future direct tax system under Pillar One?

4.3.1. VAT as a Current Solution

At present, VAT is Indonesia's primary tool for taxing the digital economy, given the government's decision not to pursue direct taxes. Relying solely on the uncertain timeline of a global Pillar One agreement is not feasible. Consequently, using VAT to generate tax revenue from the digital sector is essential. Although Indonesia cannot tax the profits of foreign digital companies, it has managed to collect 16.9 trillion Rupiah (USD 1.1 billion) in VAT over four years from digital goods and services (DDTC, 2023).

Moreover, the adoption of Pillar One is expected to require a multilateral approach. Even when an agreement is reached, countries will need to amend their domestic laws to align with Pillar One provisions, a process that may be time-consuming, particularly for developing nations like Indonesia with limited tax administrative capacity (Avi-Yonah, 2022). Until these changes take effect, VAT offers a practical interim solution for generating revenue from the digital economy.



Another alternative, besides VAT, is the withholding tax on Automated Digital Services (ADS) outlined in Article 12B of the UN Model (2021). However, VAT is generally seen as the preferable choice. The ADS tax, being a newer tax, may cause interpretation challenges, ambiguities, and disputes (Mpoha, 2022). It may also be difficult to apply in B2C transactions, as most individuals lack the capacity for self-assessment and tax remittance (Schon, 2017).

By contrast, VAT is well-established in international taxation, with significant literature and best practices, such as those promoted by the OECD in the BEPS initiative, addressing its challenges in the digital age. Additionally, Indonesia's digital VAT regulations support neutrality by not distorting economic behavior, unlike the ADS tax, which applies only to businesses focused on ADS, leaving other sectors of the broader digital economy untaxed. This could potentially drive investors to sectors outside ADS.

However, from a global comparative perspective, VAT alone may not address the profit-shifting practices of large multinational enterprises (MNEs) that benefit from Indonesia's consumer market while shifting profits to low-tax jurisdictions. Thus, while VAT serves as a critical stopgap, its effectiveness will be limited without the broader international reforms envisioned under Pillar One. Moreover, socially, the reliance on VAT to tax digital services could have regressive implications, disproportionately affecting lower-income consumers who spend a higher percentage of their income on digital services. Unlike direct taxes, which can be progressive, VAT is inherently regressive, as it taxes consumption rather than income. This suggests that, while VAT may be effective in raising revenue, its broader impact on social equity must be carefully managed, particularly in countries like Indonesia, where income inequality is a persistent challenge.

To sum up, VAT serves as the most suitable current alternative, filling the gap while the world awaits a Pillar One agreement. Furthermore, compared to newer approaches like the ADS tax, VAT remains the more practical and effective option for Indonesia. However, the reliance on VAT, a regressive form of taxation, could exacerbate social inequities, disproportionately affecting lower-income consumers. Therefore, while VAT is an important tool for raising revenue from the digital economy,



it must be coupled with efforts to ensure social equity and support for broader international reforms to create a fairer, more balanced tax system.

4.3.2. VAT as a Future Supplement to Pillar One

One notable change in the Pillar One process is the shift in Amount A from targeting specific industries to a broader focus on companies with high revenue and profitability thresholds. Initially centered on digital platforms, Pillar One now applies to sectors beyond the digital economy. This scope reduction means only 78 global businesses, down from 780, will be affected by Amount A. For market countries like Indonesia, this is a disadvantage as fewer companies will be taxed under Pillar One. Meanwhile, Indonesia's digital VAT targets all foreign businesses selling digital goods or services to its consumers. Although VAT and Amount A differ (VAT taxes consumption while Amount A targets profits), VAT still serves as a valuable tool for taxing a broader range of foreign entities engaged in Indonesia's digital economy.

Under Amount A, a foreign company must generate EUR 1 million in revenue in a market jurisdiction to trigger tax obligations (with lower thresholds for smaller jurisdictions). By comparison, the sales threshold for VAT collectors in Indonesia is just 600 million Rupiah (USD 38,000), which allows Indonesia to tax a greater number of businesses. Thus, VAT in Indonesia can complement Amount A by capturing revenue from a wider range of digital transactions.

Lastly, while VAT cannot replace Amount A, it remains a useful supplement. Amount A is a direct tax targeting business profits, while VAT is an indirect tax on consumer purchases. Additionally, VAT and Amount A have different tax bases, meaning they address different aspects of the digital economy. With Pillar One's focus on taxing profits, VAT would complement the framework by continuing to tax consumption, ensuring Indonesia maximizes its digital tax base.

In summary, While VAT is essential for addressing immediate challenges, it cannot fully resolve the profit-shifting practices of MNEs, necessitating broader global cooperation. As such, VAT and Pillar One, when fully implemented, could offer Indonesia a dual-pronged approach to maximizing tax revenue from the digital economy while addressing



broader challenges in the international tax landscape.

5 CONCLUSION

This study has explored the effectiveness of VAT in addressing the challenges Indonesia faces regarding low-value imports, remote digital supplies, and its potential role as an interim solution and complement to Pillar One.

This paper determines that Indonesia's regulatory shift, lowering the VAT exemption threshold, has been effective in capturing revenue and leveling the playing field between foreign and domestic suppliers. However, the high administrative costs and complexity of collecting VAT on small transactions present challenges that may reduce the net gains. Adopting a comprehensive vendor collection method would streamline tax collection, reduce administrative burdens, and ensure compliance, making foreign vendors responsible for VAT collection. This approach aligns with global best practices and supports fairer competition between domestic and international businesses.

In regard to the challenge posed by remote digital supplies, Indonesia's application of VAT to remote digital supplies, also through the vendor collection method, has contributed substantially to VAT revenues from cross-border digital services. Despite this success, challenges related to fairness, legal certainty, and compliance persist, particularly regarding foreign businesses' uneven registration and enforcement. Strengthening enforcement and providing clearer regulations would further stabilize the system and boost international trust in Indonesia's VAT framework.

Given VAT's current success in addressing these challenges and the ongoing uncertainty surrounding the global implementation of Pillar One, VAT remains the most appropriate tool for taxing the digital economy in Indonesia. VAT has emerged as a practical stopgap measure while awaiting global consensus on Pillar One. Although it cannot address profit-shifting practices by multinational enterprises (MNEs), it remains a reliable tool for taxing consumption in the digital economy. VAT will continue to be relevant until the country can fully integrate the Pillar One framework. Furthermore, in the future, a dual approach, combining VAT



and Amount A of Pillar One, would offer Indonesia a comprehensive framework for maximizing digital tax revenue.

Future research should explore how VAT can better align with evolving global tax frameworks, such as Pillar One, while ensuring a more equitable distribution of the tax burden. By connecting the findings to the OECD's theoretical framework on digital taxation, it becomes clear that Indonesia's VAT measures reflect best practices in addressing immediate challenges but require ongoing refinement to ensure long-term sustainability and fairness in the digital economy

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