Digital Services Tax: Challenge of International Cooperation For Harmonization

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Abstract
The spread of the digital economy brings about many benefits, for example in terms of growth, employment and well-being more generally. These challenges extend well beyond domestic and international tax policy and touch upon areas such as international privacy law and data protection, as well as accounting and regulation, a strategic tax policy perspective, the uptake of digital technologies may potentially constrain the options available to policymakers in relation to the overall tax mix. Technological innovation and the growth of the Internet have profoundly affected trade relations, production processes and products, and the organization of companies. The digital economy is characterized by several key elements, such as: massive expansion of intangible assets; intensive use of data (especially personal data) and widespread adoption of multi-faceted business models that exploit the value externalities of free assets. As the digital economy brings us into new territory, is fair taxation fiction or reality? Although overcoming the numerous challenges will be a difficult task for policy makers, fair taxation of the digital economy is a reality. A prerequisite to making a sustainable change is enthusiastic country commitment and international cooperation. Asia and the Pacific region need to pull together and push forward the necessary reforms, innovate tax structures and administration, and continue to learn from each other's experiences. Other key enablers include a coherent strategy and strong evidence-based communication and knowledge.

Keywords: Digital Economy, Digital product, DST, BEPs, technological innovation, taxation, international cooperation.

INTRODUCTION
The spread of the digital economy brings about many benefits, for example in terms of growth, employment and well-being more generally. As technology merges with the economy, we have witnessed the rise of the digital economy, which is growing day by day. In particular, the spread of the digital economy creates challenges for international taxation as well as domestic tax revenue mobilization. The digitally dependent economy ranges from 17% to 35% of GDP per economy, with services sectors being more digitized than other sectors. Taxing the digital economy is difficult to regulate. There are many types of digital businesses and each specific case has to be considered individually.

In both areas, there is an important debate about the formal obligations of economic operators in general, and those of digital platforms in particular. The development of digital technologies has the potential to enable economic actors to operate in ways that avoid, remove, or significantly reduce, their tax liability within these bases. It does not specifically relate to digital businesses. As we have seen over the last few years, the digital economy can and will make a difference to many areas, and monitoring and measuring these changes are vital.

Advantage
Other elements of the digital economy have also raised challenges for policy makers. The digitalization of the economy introduced new digital business models which did not require a physical presence to carry out digital transactions. The erosion of physical barriers between producers and consumers in different countries, resulting out of the Internet through which digital business models advertised their goods and services to consumers globally, prevented governments from directly taxing these digital corporations. To reduce the tax gap arising out of legislation that permitted the taxation of ‘brick and mortar’ companies and was silent around
digital companies, governments started to actively discuss ideas around direct taxation of digital corporations.

Such thinking around imposing the digital tax started gaining traction around 2013 with the OECD and G20’s Inclusive Framework on Base Erosion and Profit Shifting project. This raises the issues of how to attribute value created from the generation of data through digital products and services, and of how to characterise for tax purposes a person or entity’s supply of data in a transaction, for example, as a free supply of a good, as a barter transaction, or some other way. These challenges raise questions as to whether the current international tax framework continues to be appropriate to deal with the changes brought about by the digital economy and the business models that it makes possible, and also relate to the allocation of taxing rights between source and residence jurisdictions. The new digital tax function might evolve at great pace to become a strategic component of enterprise transformation. Advances in digital technology have not changed the fundamental nature of the core activities that businesses carry out as part of a business model to generate profits.

Disadvantages and other considerations of DST

While DST is a solution to the lack of source-based taxation in the emerging digital economy, it is important to consider how it fits into our current taxation framework, the ways in which it distorts economic activity, its economic events, and their distribution impact. In terms of digital services, they increase input costs for businesses and undermine the international competitiveness of Indonesian businesses. France’s DST general balance model estimates that, «About 55% of the total tax burden will be borne by consumers, 40% by businesses using digital platforms, and only 5% by the big internet.» In the Indonesian context, Google claims to support «IDR trillion in annual economic activity for the Indonesian businesses that connect with consumers through Google.» Additionally, in 2020 Google «supported IDR Trillion in free for Indonesian consumers, saving an average of 31 Indonesian hours searching for information on the web and 29 hours in transport time.» The Indonesian Bureau of Statistics found that digital activity accounts for a disproportionate amount of Indonesia’s total GDP growth.

As a percentage of GDP, Indonesia has one of the highest levels of contribution from the digital economy. Digital companies have significantly increased downstream competition in music, retail, and small business. Thus, taxing the income generated by these companies in Indonesia directly impacts Indonesian businesses and consumers who will bear the burden and will slow down the economic growth that these digital companies support. First, DST will dismantle the neutral treatment between digital and non-digital companies in the tax code.

Simplicity is one of the hallmarks of good tax design26, and the complexity created by thresholds and different definitions between digital and non-digital companies is the kind of complexity that companies take advantage of to pay less tax. Since the DST revenue threshold only applies to international digital companies, French digital companies have the competitive advantage of a higher tax burden. Indonesian consumers freely provide their data to digital companies who in return provide services at no cost. Extending this analogy, we can view this economic activity as a form of bartering in which consumers provide data in exchange for non-taxable income in the form of free services from digital companies.

Tax policy options and OECD BEP’s Action Plan

In addition, because of these peculiarities, the digital economy poses significant problems for tax design, particularly regarding the division of the tax base, the qualification of values to be taxed, and the arrangement of withdrawals. This could include implementing a global minimum tax that would equalize tax treatment between digital and non-digital companies. «Country of destination» here refers to countries with users of digital goods and services in countries other than the country, or countries, where the digital MNE is located. In addition to
considering DST, harmonization of cross-border regulations, and minimum corporate taxes, the OECD has recommended including digital goods into the country's Value Added Tax framework and removing existing tax benefits for digital companies.

Indonesia adopted the OECD recommendations and began implementing VAT for imported digital goods and services in 2020. Having done so, Indonesia has reported accumulating additional revenue of IDR 3.5 billion during 2020-2021 from digital goods and services. This is a neutral extension of the consumption tax base to include digital companies but does not address the business-to-business nature of many transactions in the digital economy and does not address broader changes to international corporate taxation provisions. When the digital economy is at stake, these conventional models are no longer effective.

Digital multinational trade without a permanent establishment in the destination country, completely avoids profit tax based on source criteria.

**Digital Services Taxation (DST): General Framework**

The digitalization of the global economy has allowed companies to reach new markets and create jobs around the world without a physical presence, leading to concerns about tax evasion by MNEs. In addition, these digital companies rely on intangible assets and are highly mobile. These two factors make it relatively easy for MNEs to engage in profit transfer and other forms of tax evasion. DST advocates point out the geographic mismatch of where digital companies are based and pay taxes and where the majority of their consumers live.

For example, the United States is home to 37% of the digital economy but only 11% of global internet users. This discrepancy in the distribution of digital producers and users creates political pressure to realign taxation with users' locations. Digital MNEs create value from user data, frustrating governments in countries with users but without a digital physical presence company. The current tax model makes it difficult for these «destination» countries to tax this value creation.

In fact, the COVID-19 pandemic could accelerate the profits of this digital giant. Another concern arises is that these MNEs can manipulate the content people see and, through this, have the potential to have the power to influence how people think. All these subjects can be found in different countries. This service targets users in both non-Members and Member States.

DST is divided between Member States 1 and 2 according to the number of times the ad has been shown or, simply assuming one view per user, according to the number of users. The tax bases are 500 and 250 for Member States 1 and 2. Users in third countries are taken into account in the calculation of each member state's share.

**Tax policy options**

In a tax competition regime, the digital economy exacerbates the problem of tax base erosion, offering opportunities for elusive practices above those already exploited by the traditional economy. For digital multinationals, tax competition has produced a race to the bottom with their implicit tax rates being close to zero. Moreover, because of these peculiarities, the digital economy raises significant problems for tax design, in particular regarding tax base apportionment, qualification of the values to be taxed, and withdrawal arrangements. At international level, direct taxation is based on both residence and source criteria.

For a long time, a widespread system of bilateral and multilateral conventional agreement has guaranteed a tax base distribution between the residence and the source countries, avoiding double taxation and conflicts related to the taxing rights. When the digital economy is at stake, these conventional models are no longer effective. In the first case, the problem lies in preventing taxes on corporate income from being evaded by exploiting transfer mechanisms and the shifting of taxable bases to countries with favourable tax regimes. Then,
the US claims worldwide extra profit taxation, given that the digital multinationals are the exclusive owners of intangibles.

In the second case, the digital multinationals trade without a permanent establishment in destination countries, completely avoiding profit taxation by source criteria. In particular, users of digital platforms and networks are central because of their contributions, either active or passive and mostly free, to value creation. The OECD Base Erosion and Profit Shifting project has contributed to the debate on digital economy taxation, even if it does not recommend ad hoc taxation for digital enterprises. This is a peculiar levy, as it is based on the total revenues collected by multinationals, but the tax yield is assigned to each Member State according to their domestic share of global digital users.

EU governments agree that tax rules should be changed to increase levies on digital services that are currently under-taxed, but are at odds over the process to reach this target. On the one hand, smaller states with lower tax rates, such as Luxembourg and Ireland, which host large US multinationals, want the EU changes to come together with a global reform of digital taxation. On the other hand, larger states, such as France and Indonesia, which claim to suffer large tax losses due to digital companies shifting profits to lower-tax countries, are pushing for a quick solution. In general, the DST aims to tax revenues of digital businesses that are considered to derive significant value from the participation of their users.

As a significant number of digital companies are active in more than one jurisdiction, an increasing number of unilateral and country specific measures increase competitive distortions, compliance burden and double taxation disputes. Digital MNEs can generate substantial value in countries like Indonesia with minimal physical presence and consequently paying little tax. The European Commission found that within the EU, digital companies are subject to an average effective tax rate of 9.5% while traditional business models, with more physical presence, are subject to an average effective tax rate of 23%. This has given momentum to efforts countries to tax these foreign digital companies.

From this point of view, we analyse what possible configurations the OECD digital services taxation system could take after the unilateral actions taken by Indonesia and the reactions by other OECD countries. These benefits have proven to disproportionately benefit digital giants and reduce their tax burden to lower rates than the mainstream.

**Indonesia’s Tax Policy Option in responding Digital Service Tax**

Indonesia’s recent decision to unilaterally introduce a digital services tax in accordance with the tax scheme proposed by the European Commission raises a number of interesting points. These are related to the distinctive nature of these levies, which tax the total income collected from multinational corporations but divide the tax proceeds accordingly among single member countries according to the domestic share of digital users. Indonesia collects less than half of its potential tax revenue. Given Indonesia’s declining tax revenues and growing spending needs, improvements in both tax policy and administration will be needed to fund Indonesia’s development priorities while ensuring fiscal sustainability.

Moreover, Indonesia will need to expand its tax base by identifying and utilizing new sources of tax revenue. With the rapid globalization and digitalization of the global economy, the question of how countries should approach the taxation of digital multinational corporations has become a topic of international tax policy discussion. Indonesia is considering in implementing OECD measures, including expanding its Value Added Tax to include imported digital goods and services. The Digital Services Tax is a tax on selected revenue streams of multinational digital companies.

In today’s economy, most businesses have adopted some digital elements into their business practices. Early attempts to implement digital taxes sought to define a digital business model. Across the globe, the pandemic has driven changes in patterns of work, learning, communication, leisure and consumption, with a sharp increase in internet usage and a more rapid uptake of new digital technologies. Internet penetration in Indonesia increased from
69.5% of the population prior to the pandemic to 80% by the midpoint of 2021. During this time, an additional 21 million new digital consumers were created.

Indonesia’s internet economy is expected to reach a total value of $70 billion in 2021, an increase of 49% year-on-year, with the value of online transactions predicted to double again to $147 billion by 2025. While the surge in digital economic activity offers the potential for new sources of tax revenues, countries across the region have grappled with the challenge of taxing the digital economy, and particularly intangible digital services provided by non-resident enterprises. The intangible nature of imported digital services, and the lack of physical trace of transactions at international borders makes the taxation of cross border digital services difficult to enforce. This puts domestic digital service providers at a competitive disadvantage since resident businesses are subject to income taxes and are required to register, charge and remit VAT.

In response, many Asian countries have been developing regulatory mechanisms to capture VAT on digital goods and services supplied from abroad to ensure a level playing field with domestic digital service providers. While waiting for a global deal, Indonesia has recently decided to act unilaterally by-passing Laws No. The Indonesian DST is closely modelled on the EC interim proposal and can be viewed as a single building block of the new harmonized tax introduced by many countries including Indonesia. In 2019, Indonesia introduced a law on e-commerce to improve the governance of internet-based and define tax obligations for digital businesses.

Section 2 discusses issues in digital economy taxation and describes newer policy initiatives proposed, or implemented, at the international and national levels, to address this problem. In particular, the proposed digital services tax applied by OECD countries is described together with a specific DST that will be unilaterally implemented by Indonesia, starting in 2020. This paper presents a simplified general framework, useful for highlighting the main problems of the DST scheme elements and possible strategies that one country can adopt to tax the digital economy. A digital product means a product that is obtained electronically by the buyer or delivered by means other than tangible storage media using technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.

The Indonesian government also levied a value-added tax on the provision of intangible goods or services in Indonesia. Otherwise, Indonesia might share the experience of the EU, which struggles with low levels of compliance and a lack of enforcement. Since the PMSE VAT regulation came into effect in July 2020, the DGT has only revoked it once, namely PT Fashion E-service Indonesia in December 2020. The PMSE VAT collection is part of the government’s efforts to create justice by maintaining a level playing field between conventional and digital business actors.

It still maintains previous procedures for conventional tax disputes with penalties that hardly apply to the digital economy. The growth of the digital economy saw the emergence of several Indonesian «unicorns», which are digital start-ups with a market capitalization of more than USD 1 billion, but also a significant presence of foreign operators. Among others, it aims to impose income taxes on electronic systems transactions by foreign service providers with ‘significant economic presence’ which would constitute a permanent establishment in Indonesia. When the threshold for ‘significant economic presence’ is met, these corporations will then be subject to paying corporate income tax in Indonesia.

However, challenges remain in determining the proportion of the business profit sourced in Indonesia and how to share the right to tax corporate profits with the authorities of the company’s residence abroad. While this type of tax has not been implemented by the Indonesia government, multilateral consultation needs to continue in order to arrive at a mutually-agreed international tax framework. Since Indonesia’s tax-to-GDP ratio stands a few percentage points below those of neighbouring countries like Malaysia, Singapore or China, there appears to be room for broadening the tax base to increase the country’s tax revenues. Following that
rationale, the Indonesian government decided to start taxing intangible products offered by foreign digital service providers to support the National Economic Recovery Program.

Taxes include both, a direct corporate income tax imposed on the income of foreign service providers as well as an indirect Value-Added Tax levied on the consumption of OTT electronic transactions in Indonesia. Moreover, since 2017, the Indonesian government has also been involved in international discussions about custom duties on the import of intangible digital products. The limitations of certain criteria for PMSE VAT collectors include first, the value of transactions with buyers in Indonesia exceeds Rp. Second, the number of traffic or accessors in Indonesia exceeds 12,000 in a year or 1,000 in a month.

The appointment of a VAT collector is based solely on the value of transactions with buyers in Indonesia, or the amount of traffic or access from Indonesia, regardless of the domicile or jurisdiction of the domicile of the business actors,» said the DGT statement in its official statement. The PMSE VAT provisions are correct, the economic activity of digital platforms has increased in the midst of the Covid-19 pandemic.

RESULTS AND DISCUSSION

These measures aim at expanding the definition of nexus by accounting for significant economic presence and allowing for the taxation of profits of a non-resident corporation regardless of the physical presence in the taxing jurisdiction. The new taxing right allows to overcome the limitations of the permanent establishment concept and to prevent double taxation. The potential of this instrument will depend on the widespread inclusion of the provision in the existing network of double taxation treaties. The current taxation rule has allocated profits to the jurisdiction where a PE is located, depending on the functions that PE is performing and the risks it undertakes, and taxes the profits according to its activities.

Taxation on the digital economy has evolved from a challenge of taxation on large IT companies to a bigger discussion on how the international taxation system should be. In the case that international rulemaking on taxation of digital economy is delayed, other jurisdictions are likely to continue to introduce unilateral digital service taxes. With many jurisdictions carrying out unilateral taxation, companies will pay each digital service tax in each jurisdiction, along with the possibility of double taxation, and their compliance cost will increase. The question is whether we can establish a solid framework for new taxation rules with common understanding across nations, and work is underway to thoroughly examine this at the OECD.

| Country | Enacted | Date       | Digital PE WHT                           | Note                                      |
|---------|---------|------------|------------------------------------------|-------------------------------------------|
| India   | Enacted | 01-Apr-22  | Revenue related to the digital PE         |                                           |
|         | Enacted | 01-Oct-20  | Gross amount of sale of goods or provision of service facilitated through digital or electronic facility or platform |
|         | Enacted | 01-Jun-16  | Equalization levy                        | Gross amount of online advertising payments |
|         | Enacted | 01-Apr-20  | Equalization levy                        | Online sale of goods, provision of services or services facilitation (when operator provides platform for others to supply service) |
| Indonesia| Enacted | 31-Mar-20  | Digital PE                               | Revenue related to the digital PE         |
CONCLUDING

A. As technology merges with the economy, the rise of the digital economy will create challenges for international taxation as well as domestic tax revenue mobilization, including determining where tax must be paid, collecting value-added-tax (VAT), and clarifying the treatment of workers in the new economy. The first major attempt to align tax policy with today’s contemporary economy was the Action Plan on Base Erosion and Profit Shifting. It stresses the need for change to the traditional jurisdictional approach and identifies four vital focus areas: treaty shopping, country-by-country reporting, dispute resolution, and harmful tax practices.

B. As the digital economy brings us into new territory, is fair taxation fiction or reality? Although overcoming the numerous challenges will be a difficult task for policy makers, fair taxation of the digital economy is a reality. A prerequisite to making real sustainable change is enthusiastic country commitment and international cooperation. Asia and the Pacific region need to pull together and push forward the necessary reforms, innovate tax structures and administration, and continue to learn from each other’s experiences. Other key enablers include a coherent strategy and strong evidence-based communication and knowledge.

C. Reforms in the international tax framework may also have implications for competition in digital services sectors. As cross-border digital services expand, the compliance of foreign
digital service providers to register and remit VAT/GST taxes may become a precondition for their operation. A tax framework including foreign suppliers of digital services may ensure they have the same opportunities as domestic suppliers.

D. From the perspective of both governments and firms, the implementation of the OECD/G20 Inclusive Framework multilateral solution will increase compliance costs while at the same time providing tax certainty. To ensure proper implementation, efforts to upgrade the current tax framework and tax practices will be needed. Jurisdictions will need to develop domestic legislation implemented in association with a multilateral review process of the rules to be implemented. International law will need to be developed to overcome obstacles in tax treaties, in particular the development of a new multilateral convention that addresses existing treaty barriers such as Article 7 (Business Profits) of double taxation treaties. For tax administrations, an important design tool for the appropriate application of the agreement relies on the existence of a shared filing

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