

# Legal Formulation to Overcome Base-Erosion and Profit-Shifting Practices of Digital-Economy Multinational Enterprise in Indonesia

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## Abstract

This study discusses Indonesian legal strategies and formulations to handle tax avoidance originating from Base Erosion Profit Shifting (BEPS) carried out by the digital-economy multinational enterprise. It is a normative (doctrinal) study supported by non-doctrinal methods to reveal the truth based on the logic of legal scholarship. It also compared the practices to the tax provisions, legislation, and cases in India, the United Kingdom, Australia, and Malaysia. At least two theories underlie the study. The first is the legal theory of justice, certainty, and expediency from Gustav Radbruch. The second is the theory of international cooperation. The study found several points. First, multinational enterprise strategies avoid tax by means of Permanent Establishment techniques in low-tax jurisdictions, transfer pricing, and tax treaty shopping. Second, to tackle the multinational enterprise that conducts BEPS in the field of the digital economy, (1) all countries have developed and amended laws and regulations related to e-commerce taxation and the digital economy; and (2) all countries carry out international cooperation, both bilaterally and multilaterally through tax treaties, MLI, and CbC reporting.

**Keywords:** BEPS, digital economy, Indonesia.

## A. Introduction

This study was triggered by the anxiety and problems of international taxation originating from digital transactions. Indonesia, especially, has found it challenging to apply taxes for international business practitioners, in this case, Multinational Enterprise (MNE), which runs the digital business economy. The development of information and communication technology (ICT) has shifted traditional transactions to digital/online transactions. The digital economy includes all variables and participants of the "digital value process." The area of the economy consists of and is directly influenced by certain factors, such as multi-media agencies, e-commerce, interactive online marketing, mobile solutions, providers, game developers, social media providers, etc.<sup>1</sup> Digital transactions include several advantages: (1) trade transactions become more effective and faster; (2) trade

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<sup>1</sup> L. R. Gazieva, T. R. Magomaev, and L. R. Magomaeva, "The Impact of E-Commerce on The Digital Economy," in *FETDE 2020 International Conference on Finance, Entrepreneurship and Technologies in Digital Economy*, 2020, 122-126.

transactions become more efficient, productive, and competitive; (3) it gives more speed and accuracy to consumers. The ICT has also changed the ways in which products and services are produced and delivered. Companies, either MNEs or start-ups, have new payment mechanisms. One of which is a digital currency.<sup>2</sup> The development of ICT also leads to several new types of online business, such as e-commerce, app stores, online advertising, cloud computing, participative networked platforms, high-speed trading, and online payment services.<sup>3</sup> Many business models are developing digitally, either Business to Business (B2B) and Business to Consumer (B2C). They provide various services such as social media platforms, search engines, online marketplaces, etc.<sup>4</sup> The most typical business models are e-tailers (e.g. Amazon), content providers, transaction brokers (e.g. PayPal), market makers (e.g. Amazon), portals (e.g. Google) and community providers (e.g. Facebook).<sup>5</sup> Although there are many different digital economy revenue models, most companies rely on one, or several, combinations of revenue models, such as advertising, subscription, transaction fee, sales, and affiliate.<sup>6</sup>

The current evolution of the internet has increased the interaction between people from different societies, and transcended national boundaries giving rise to a rapid territorial effect in the modern global economy.<sup>7</sup> It is difficult for the government and/or tax authorities<sup>8</sup> to determine appropriate nexus<sup>9</sup> that allows the use of tax jurisdictions<sup>10</sup> on cross-border sales.<sup>11</sup> *Digital economy*<sup>12</sup> create the

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<sup>2</sup> OECD, *Addressing the Tax Challenges of the Digital Economy: Action 1 2015 Final Report* (Paris: OECD Publishing, 2015), 52.

<sup>3</sup> OECD, 54.

<sup>4</sup> Zinovy Radovitsky, *Business Models for E-Commerce* (India: Cognella Academic Publishing, 2015), 11.

<sup>5</sup> Aleksandra Bal (et.al.), *International Tax Structures in the BEPS Era: An Analysis of Anti-Abuse Measures* (Amsterdam: IBFD, 2015), 254.

<sup>6</sup> Kenneth C. Laudon Traver, and Carol Guercio, *E-Commerce: Business, Technology* (New Jersey: Pearson Education. Inc, 2014), 60.

<sup>7</sup> Subhajit Basu, *Global Perspectives on E-Commerce Taxation Law* (England: Ashgate Publishing Limited, 2007), 7.

<sup>8</sup> The complexity of the e-commerce taxation problem stems from the simplicity of the definition of e-commerce which tends to be deceptive, namely, the act of buying or selling goods or services using electronic resources. This explanation hides the complexities facing regulators and the enormous economic importance of the phenomenon. Andrej Savin, *EU Internet Law* (UK: Edward Elgar Publishing Limited, 2013), 28; A.J Cockfield, "BEPS and Global Digital Taxation", *Tax Notes International* 75, no. 11 (2014): 933-940.

<sup>9</sup> Arthur Cockfield, "BEPS and Global Digital Taxation", *Tax Notes Int'l* 75, no. 11 (2014): 938. Nexus was originally a very simple concept based on physical existence. But physical presence extensions are getting eroded, such as: Third-party Nexus, Click-through nexus, Affiliate Nexus, or Three-Channel Nexus. Taxify, "Introduction To Nexus: What Is It, And How Does It Affect Your Ecommerce Business?", accessed October 19, 2020, <https://taxify.co/2014/06/17/nexus-simply-defined/>.

<sup>10</sup> Annette Nellen, "Internet Taxation and Principles of Good Tax Policy," (San Jose State University Manuscript, 2012), 3.

<sup>11</sup> Basu, *Global Perspectives on E-Commerce Taxation Law*, 4.

<sup>12</sup> Article 1 paragraph (2) of Law Number 11 of 2008 concerning Information and Electronic Transactions; Circular Letter of the Directorate General of Taxes Number SE-62/PJ/2013 on the Affirmation of Tax Provisions on E-Commerce Transactions; Steef Huibregtse and Avisha Sood, *Digital Economy Handbook 2016*:

most appropriate context in which international tax theories, principles, rules, and policies must be examined, challenged, and reconsidered. Furthermore, the development of ICT through digital transactions makes it easier for business actors (the MNEs) to carry out tax planning and/or tax avoidance in a neat and structured manner or practice Base Erosion Profit Shifting (BEPS).

The implementation of digital taxes is expected to provide a sense of justice, economic growth, competition, and level-and-healthy competition as well as increase economic growth. However, digital taxes also have drawbacks (including tax avoidance practices) and illicit financial flows through profit shifting practices. For instance, some online companies do not report who will be investigated if the company office is not domiciled in Indonesia and how to resolve disputes. The increase in digital economy transactions globally, including in Indonesia, does not necessarily have a positive correlation with tax revenues from the sector. The difficulty of taxing the sector is because the tax system and regulations still refer to traditional transactions and require physical presence. On the other hand, Indonesia is also bound by the tax treaty that still holistically accommodates the taxation of digital transactions. There are three main issues of the study as follows.

1. What is the BEPS technique that MNEs usually use to avoid taxes in the digital economy business?
2. What are the strategies of India, Australia, Britain, and Malaysia to deal with MNEs who practice BEPS in the digital economy?
3. What kind of legal formulation should Indonesia create to tackle BEPS practices in the digital economy?

The methodology of the study will analyze all data related to digital economy taxation by means of conceptual, case, and comparative approaches based on Radbruch's theory of justice, certainty, and benefit, as well as the theory of international cooperation to be matched with the conditions in Indonesia and international dynamics. Therefore, a new perspective or concept can be obtained, both from the experience of other countries and from the legal experience, to establish legal formulations for taxation and narrow the space for tax avoidance and evasion. It is a normative (doctrinal)<sup>13</sup> study supported by non-doctrinal research methods. The normative legal research method is a scientific research procedure to find the truth based on the logic of legal scholarship from the normative side.<sup>14</sup> The study will use (1) a conceptual approach, (2) a comparative approach, and (3) a case approach.<sup>15</sup>

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*Tax, Transfer Pricing and Other Legal Aspects of Business Configurations*, (Amsterdam: Transfer Pricing Technologies BV, 2016), 15.

<sup>13</sup> Soetandyo Wignjosobroto, *Hukum Paradigma, Metode Dan Dinamika Masalahnya*, (Jakarta: ELSAM, 2002), 147; Anwarul Yaqin, *Legal Research and Writing*, (Malaysia: Lexis Nexis, 2011), 10.

<sup>14</sup> Hardijan Rusli, "Metode Penelitian Hukum Normatif: Bagaimana?", *Law Review Fakultas Hukum Universitas Pelita Harapan* 5, no. 3 (2006), 40.

<sup>15</sup> Johny Ibrahim, *Teori Dan Metodologi Hukum Normatif*, (Malang: Banyu Media Publishing, 2006), 300.

This study uses two theories: (1) the theory of justice from Radbruch; and (2) the theory of international cooperation. These theories generate four important principles for regulating digital economy taxation in Indonesia. First, the principle of justice is based on the idea that everyone is treated equally and given the rights and duties that are their rights, according to the rules, in a fair and non-discriminatory manner. Consideration of justice is needed to allocate goods limitedly in each society. On the other hand, justice is demanded in all human relations.<sup>16</sup> From a legal perspective, justice has become an important anchor to achieve a legal system that is considered legitimate and legitimate among its members, and, likewise, the identification of two aspects of justice, vertical and horizontal justice. The tax system should achieve the appropriate level of vertical equity, there is a consensus on the concept of horizontal equity. Therefore, people in the same situation should pay the same amount of tax. In other words, sellers who sell goods through traditional stores with those who sell goods through online stores must be subject to the same types and rates of taxes.<sup>17</sup> Taxpayers pay proper tax obligations with easy and simple administration.<sup>18</sup> Therefore, to realize fair and efficient taxation,<sup>19</sup> especially in digital economy taxation, it is important to pay attention to the following points.

1. Any income and/or added value obtained in the Indonesian jurisdiction must be subject to tax, whether it is income tax and/or relevant VAT.<sup>20</sup>
2. There is no significant difference in determining the subject and object of tax law between domestic and cross-border transactions, or between traditional transactions (physically) and transactions without a physical presence (online).
3. There is no significant difference in determining the tax object, whether it comes from the field of income tax law (PPh) and Value added tax (VAT).
4. There should be no differences regarding: general provisions and taxation procedures, tax rates, tax bases, and tax administration.

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<sup>16</sup> Peter Hongler, *Justice in International Tax Law: A Normative Review of the International Tax Regime*, (Amsterdam: IBFD, 2019), 5.

<sup>17</sup> Arthur J. Cockfield, "Transforming the Internet into a Taxable Forum: A Case Study in E-Commerce Taxation", *Minnesota Law Review* 85, no. 5 (2001): 1171–1266.

<sup>18</sup> Jeffrey Owens, "Fundamental Tax Reform: An International Perspective", *National Tax Journal* 59, no. 1 (2006): 131–164.

<sup>19</sup> Charles R.T. O'Kelley, "Rawls, Justice, and the Income Tax Rawls, Justice, and the Income Tax", *Georgia Law Review* 16, no. 1 (1981): 1–32.

<sup>20</sup> The function of implementing PMSE VAT is to realize the spirit of taxation to create a level playing field. It needs to be realized immediately considering that so far companies such as Google, Facebook, Netflix, and Spotify can be taxed so that the principle of justice will be created from equality of business. Fried food sellers who have been paying 0.5% final income tax (the VAT) are no longer oppressed by companies such as Google, Facebook, Netflix, and Spotify because now they also must pay taxes in Indonesia. Rendy Brayen Latuputty, "PMSE: Pajak Di Era Normal Baru", accessed March 24, 2021, <https://pajak.go.id/id/artikel/pmse-pajak-di-era-normal-baru>.

Secondly, the principle of legal certainty refers to the regulation of digital economy taxation in Indonesia. It must pay attention to stability requirements as an aspect of the principle of legal certainty. However, the principle also includes several other aspects, such as enforcement, non-retroactivity, and clarity of laws. Legal certainty is a guideline for enforceability and justice. It must support an order that is reasonable. The law can carry out its function to contain justice only because it is fair and certain.<sup>21</sup> Legal certainty in the field of tax law must emphasize the clarity of digital economy tax regulations. Firstly, it must contain clear and logical provisions.<sup>22</sup> Tax provisions will become a series in the legal norm system so that they do not conflict with other tax regulations and cause conflicting norms. Secondly, the legal rules may not apply retroactively. If they are applied, then retroactive tax laws must meet certain requirements based on soft law instruments.<sup>23</sup> Thirdly, legal certainty is certainty in carrying out tax obligations and tax administration.<sup>24</sup> Therefore, legal decisions made by legal institutions (either executive, legislative, or judicial) must be in accordance with the positive law.<sup>25</sup>

Then, the third principle is legal expediency. It refers to the benefits of the law to realize justice, order, and happiness.<sup>26</sup> Hence, the law must be endeavored to effectively regulate matters that have not been regulated by fully paying attention to the legal principles attached to the proposed regulation. The law must also pay attention to the element of efficiency at the time of its implementation and emphasize the content, not the formality, the substance over the form.<sup>27</sup> Proposals for digital economy taxation arrangements must provide benefits to both the state and business actors. The state will get additional state revenue from a more stable taxation sector.<sup>28</sup> Traditional entrepreneurs through physical stores will be able to compete more with the online entrepreneurs, especially international entrepreneurs who have been favored by the absence of taxation.<sup>29</sup>

The last principle is the principle of international cooperation.<sup>30</sup> It is needed to secure tax revenue from the digital economy sector. However, taxation policies through the design of tax legislation, either domestically, bilaterally, multilaterally,

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<sup>21</sup> Hans Gribnau, "Equality, Legal Certainty and Tax Legislation in the Netherlands Fundamental Legal Principles as Checks on Legislative Power: A Case Study", *Utrecht Law Review* 9, no. 2 (2013): 52–74.

<sup>22</sup> Gribnau, 52–74.

<sup>23</sup> Gribnau, 52–74.

<sup>24</sup> Article 13 paragraph (4) of Law Number 6 of 1983 on General Provisions and Tax Procedures.

<sup>25</sup> Muh. Guntur, "Kepastian Hukum Dan Rasa Keadilan Masyarakat Menuju Indonesia Baru", accessed January 22, 2021, <https://simposiumjai.ui.ac.id/wp-content/uploads/20/2020/03/8.1.1-Muh.-Guntur.pdf>.

<sup>26</sup> Suwardi Sagama, "Analisis Konsep Keadilan, Kepastian Hukum Dan Kemanfaatan Dalam Pengelolaan Lingkungan", *Mazahib* 15, no. 1 (2016): 20–41.

<sup>27</sup> DJKN, "Keadilan vs Kepastian Hukum", 2013, accessed January 22, 2021, <https://www.djkn.kemenkeu.go.id/berita/baca/29/Keadilan-vs-Kepastian-Hukum.html>.

<sup>28</sup> Law Number 6 of 1983 on General Provisions and Tax Procedures.

<sup>29</sup> DJP, "Lagi, DJP Tunjuk 10 Perusahaan Pemungut PPN PMSE", 2020, accessed March 23, 2021, <https://www.pajak.go.id/id/siaran-pers/lagi-djp-tunjuk-10-perusahaan-pemungut-ppn-pmse>.

<sup>30</sup> Brandon J Kinne, "Network Dynamics and the Evolution of International Cooperation", *The American Political Science Review* 107, no. 4 (2013): 766–785.

and internationally affect Indonesia's tax performance amid unhealthy tax competition in the international taxation field. Indonesia needs cooperation to realize its goals and reduce rejection or suspicion from foreign parties (both MNE and domicile jurisdiction). The principle of international cooperation will be used at the level of bilateral or multilateral cooperation; be it in tax treaty negotiations, implementation of domestic tax policies, cooperation in tax collection, audit cooperation, cooperation in data access and information disclosure, as well as cooperation in tax collection and collection, etc.<sup>31</sup>

## **B. Digital Economy Tax Arrangement**

### **1. Usual BEPS Techniques of MNEs to Avoid Taxes in the Digital Economy Business**

The development of the internet has facilitated the development and growth of the digital economy worldwide. There are almost no clear boundaries of the jurisdiction of a country, because of the internet. It is difficult to provide a clear picture of the boundaries of internet jurisdiction with territorial jurisdiction, which ultimately undermines the rule of law of a country. A digital economy business model of MNEs poses challenges in applying nexus, tax allocation, regulation, and administration of taxation in certain domestic tax jurisdictions, especially in Indonesia. Tax challenges posed by the digital economy include (1) cross-border transactions that challenge traditional tax regimes; (2) the possibility of increasing BEPS (tax avoidance) and tax evasion risk; (3) the difficulty of supervising tax compliance and tax administration; and (4) the increase in transfer pricing. The nature of cross-border transactions also adds complexity. They are (1) the ease of changing jurisdictions; (2) the difficulty of characterizing MNE income; (3) the easy access to international banking; (4) the increase in anonymous transactions; (5) the change of intermediary agent; (6) the increase of electronic payment systems; (7) the difficulty in determining sales tax and/or VAT; (8) the digital economy as a knowledge economy; (9) the blurry line between producers and consumers; (10) the digital economy as a global economy; and (11) the digital economy that is all about innovation. In other words, economic digitalization and other technological advances have enabled companies to be involved in the economic life of a jurisdiction without significant physical presence, which ultimately makes Nexus rules, and the existing profit allocation does not work effectively.

In addition to the challenges from the nature of digital economy transactions, the MNEs tax avoidance methods or techniques makes things worse. The techniques and practices of MNEs to smooth tax avoidance are generally carried

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<sup>31</sup> OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint* (Paris: OECD Publishing, 2020), accessed February 22, 2021, <https://www.oecd-ilibrary.org/docserver/abb4c3d1en.pdf?expires=1604167422&id=id&accname=guest&checksum=23617876A78824C600E054F2417736F>.

out in some steps. First, they use Permanent Establishment in low-tax jurisdictions. Usually, MNEs ensure that the country of origin limits their tax collection on income originating from subsidiaries located in foreign countries. To that end, MNEs have succeeded in securing the adoption of several different national tax law formulas. MNEs have other ways to limit their tax burden. MNEs will ensure wherever they have the option that the company's global income arises in very low tax jurisdictions such as Singapore, Panama, or other tax haven jurisdictions. Second, through transfer pricing techniques, MNEs will regulate the distribution of their global profits to pay minimum taxes or not be taxed at all. Transfer pricing arrangements include affiliated units located in various countries that conduct trade transactions. It is practiced when they transfer goods and services between them, and when they provide credit guarantees, research, patents, trademarks, and copyright for their subsidiaries.<sup>32</sup> Third, through the tax treaty shopping technique, MNEs usually use a tax treaty for tax exemptions to subsidiary MNEs who pay dividends to the parent MNEs, usually, the tax treaty will limit the amount to be deducted or to be paid by entities that have a special relationship in certain tax jurisdictions. Therefore, rapid developments in information technology not only have an impact on the assessment of tax obligations and collect income, but also on the ability of tax countries/jurisdictions to identify the increasing number of taxable transactions in cyberspace.<sup>33</sup>

## **2. Strategy of India, Australia, UK, and Malaysia to Deal with MNEs Practicing BEPS in the Digital Economy**

Tax authorities in various countries focus on setting transfer prices. Consequently, they are intensively monitoring and investigating the transfer pricing practices of MNEs to counter actual or suspected international transfer price maneuvers. Therefore, the main challenge facing MNEs today lies in the effective management of international transfer prices. It is an activity which has been and continues to be a central managerial concern.<sup>34</sup> The comparison of country/tax jurisdiction strategies to handle BEPS is summarized in the following table.

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<sup>32</sup> Raymond Vernon and Hurricane S Eye, *In The Hurricane's Eye: The Trouble Prospects of Multinational Enterprises* (Cambridge: Harvard University Press, 2000), 39-41.

<sup>33</sup> Jain N, "Tax Evasion a Dark Side of E-Commerce", *International Journal of Engineering and Management Research (IJEMR)* 3, no. 5 (2013): 16–18.

<sup>34</sup> Li Jian and Alan Paisey, *International Transfer Pricing in Asia Pacific: Perspectives on Trade between Australia, New Zealand and China* (New York: Palgrave Macmillan, 2005), 2.

## a. Policies of Jurisdictions in Digital Economy Taxation

**Table 1.1** Policies of Several Countries in Tax Digital Economy<sup>35</sup>

Country	Digital Economy Taxation Policy
India	<ol style="list-style-type: none"> <li>(1) Presentation of transaction data through artificial intelligence technology for data accuracy and information transparency.</li> <li>(2) India's foreign direct investment (FDI) policy allows up to 100% FDI in e-commerce companies on a B2B model but is not allowed to enter the B2C market;</li> <li>(3) The implementation of the Equalization Levy (EL) through the 2016 Income Tax Act Amendment and the 2016 Finance Act as a non-tax state collection (PNBP) at a rate of 6% if the total number of transactions exceeds INR 100,000 (equivalent to Rp. 21,500,000).<sup>36</sup></li> <li>(4) The application of VAT with 4 tariffs, namely 5%, 12%, 18%, and 28%. Most countries in the world have a single GST level: 49 countries use a single tier, 28 use two tiers, and only 5 countries, including India, use four tiers.<sup>37</sup></li> <li>(5) CBEC transactions are subject to VAT at a rate of 1% when the gross sales of sellers across e-commerce operators for 12 months is 5 lakh rupees (500,000 rupees or above \$7,000 USD). This tax is technically levied, known as a Tax Deducted at Source (TDS), remitted directly to accounts held by the central government.</li> </ol>
Australia	<ol style="list-style-type: none"> <li>(1) The application of corporate income tax (CIT) is subject to a federal tax rate of 30% of taxable income.</li> <li>(2) The application of a 10% GST for goods imported from overseas at prices below AUD 1,000 by Australian residents is effective from 1 July 2018 onwards.</li> <li>(3) Overseas online retailers who make annual sales of more than AUD 75,000 must pay 10 percent Goods and Services Tax (GST) on all sales to Australian consumers.</li> <li>(4) The Australian VAT Act makes special reference to electronic distribution platforms (EDPs). Like other legislative implementations around the world, platforms like the Apple AppStore or Google Playstore are considered providers of digital services to end customers. In this scenario, VAT registration, in addition to collecting and remitting VAT to the Australian Government, is the responsibility of</li> </ol>

<sup>35</sup> Russel Butarbutar, processed from various sources.

<sup>36</sup> Reuven S Avi-Yonah, "Three Steps Forward, One Step Back? Reflections on 'Google Taxes' and the Destination-Based Corporate Tax", *Nordic Tax Journal* 2, no. 2 (2016): 69–76.

<sup>37</sup> Bibek Debroy, "Is the World Simpler than It Was before GST? This Jury is in", accessed April 2, 2020, <https://economictimes.indiatimes.com/news/economy/policy/is-the-world-simpler-than-it-was-before-gst-this-jury-is-in/articleshow/64359881.cms>.



	the platform.
English	<ol style="list-style-type: none"> <li>(1) Enforcement of corporate income tax (CIT) at a rate of 19% for a year started from April 1, 2019. If taxable profits can be attributed to patent exploitation, a lower effective tax rate applies at a rate of 10%.</li> <li>(2) VAT is applied at 0%, 5% and 20% rates, usually the general VAT rate is usually at 20%.</li> </ol>
Malaysia	<ol style="list-style-type: none"> <li>(1) The application of corporate income tax (CIT) at a rate of 24% means that any income related to e-CT is considered to be of Malaysian origin if it is associated with any activity in Malaysia regardless of whether the income is received inside or outside Malaysia.</li> <li>(2) A 10% withholding tax (WHT) applies to all amounts paid or credited to non-residents in consideration of the service, regardless of where the service is performed.</li> <li>(3) The imposition of Sales Tax of 10%.</li> <li>(4) The imposition of a new digital tax of 6% which is set to start for foreign digital service providers will be borne by consumers. Foreign providers will collect taxes on their clients and pass the levy on to the government, in the same way local businesses collect service taxes from customers on behalf of the government from January 1, 2020.</li> <li>(5) The service tax for providing credit card or charge card services is RM25 per year for basic and supplementary cards.</li> </ol>

### b. MNE's Digital Economy Strategy in Avoiding Taxes

Table 1.2 below reveals the strategies of digital economy MNEs in avoiding taxes in several jurisdictions/countries.

**Table 1.2** MNEs. Tax Avoidance Strategies<sup>38</sup>

Country	Digital Economy Business Tax Avoidance Strategy
India	<ol style="list-style-type: none"> <li>(1) Transfer Pricing Manipulation.</li> <li>(2) Use of Permanent Establishment E-Commerce in low Tax jurisdictions.</li> <li>(3) MNE uses the Predatory Price to minimize taxes.</li> </ol>
Australia	<ol style="list-style-type: none"> <li>(1) <i>Transfer Pricing</i> Cross Borders are often associated with intellectual property (IP).</li> <li>(2) The use of an Australian Permanent Establishment operated by a foreign business to determine the amount of profit to be attributed to the Permanent Establishment and therefore taxable in Australia.</li> <li>(3) Tax Treaty Shopping. This practice is carried out by MNEs with the use of agreements by non-residents to obtain tax benefits as resident status in a jurisdiction.</li> </ol>
English	<ol style="list-style-type: none"> <li>(1) <i>Transfer Pricing</i> with the Double Irish method is practiced by many MNEs in the UK.</li> </ol>

<sup>38</sup> Russel Butarbutar, processed from various sources.

	(2) MNEs use BUTs artificially by artificially fragmenting their operations for taxes.
Malaysia	(1) MNE uses international tax instruments and structures to carry out mistransfer pricing, especially the Mistransfer Pricing of IP Assets. (2) Use of Permanent Establishment in low tax jurisdictions.

### c. India, Australia, UK and Malaysia Strategy Against MNEs Strategy in Digital Economy Tax Avoidance

Table 1.3 below reveals the jurisdictional/country policies against MNEs Strategy in Tax Avoidance in the digital economy.

**Table 1.3** Anti-Tax Avoidance Strategy of Digital Economy by Some Countries<sup>39</sup>

Country	Digital Economy Anti-Tax Avoidance Strategy
India	<p>(1) The application of a digital tax with a 6% rate was lowered to a 2% rate through Nexus, which was replaced by Significant Economic Presence (SEP) through the 2018 Finance Law with a minimum income of INR 20 million and 300,000 users. The SEP relates to payments made for transactions in respect of goods, services, or property carried out by non-residents in India including the provision of downloading data or software in India, or the submission of systematic and continuous business activities or engaging in interactions with users in India through digital means.</p> <p>(2) Transfer Pricing Regulations in India is to limit the TP strategy related to international transactions. It refers to transactions between two or more related companies (Associate Enterprises) involved in any of the following activities:</p> <ul style="list-style-type: none"> <li>a. the sale, purchase, or rental of tangible or intangible property;</li> <li>b. terms of service or cost-sharing agreements;</li> <li>c. lending or borrowing money;</li> <li>d. restructuring or reorganizing business transactions with associates, although it affects profits, revenues, losses, or assets and/or;</li> <li>e. transfer pricing arrangements, which include (1) safe harbor regulations, (2) certain domestic transactions, (3) advance price agreement, (4) country-by-country reporting, and (5) <b>transfer price documentation.</b></li> </ul> <p>(3) Simplification of Tax Administration. In October 2019, India has initiated a face-to-face e-assessment scheme. This scheme utilizes artificial intelligence (AI) in the tax assessment process, as well as the application of the Documentation Identification Number (DIN).</p>

<sup>39</sup> Russel Butarbutar, processed from various sources.

	<p>(4) Signatory of the Multilateral Convention (MLC). In June 2017, India signed an MLC to implement tax treaty related measures to prevent BEPS under the BEPS project. One of the minimum standards is to fight treaty abuse and requires countries to implement (1) a principal purpose test (PPT) or (2) a PPT together with a simplified Limit of Benefit (LOB) clause or (3) detailed LOB clauses, which can be drawn up bilaterally.</p> <p>(5) Reduced tax rates for certain domestic companies. To provide a much-needed boost to the economy, the Corporate Tax (CIT) rate is 22%.</p>
Australia	<p>(1) Nexus is replaced by a significant global entity (SGE), namely (1) a global parent entity whose annual global revenue is A\$1 billion or more. and (2) a member of a group of entities consolidated for accounting purposes where the global parent entity has annual global revenues of A\$1 billion or more.</p> <p>(2) Amendments to the Tax Law on the Combating Multinational Tax Avoidance Act 2015.</p> <p>(3) Amendments to the Goods and Services Tax (GST) Act.</p> <p>(4) Establishment of the Tax Avoidance Taskforce.</p> <p>(5) Ratification of the Multinational Anti-Avoidance Law (MAAL).</p> <p>(6) Implementing the Diverted Profit Tax.</p> <p>(7) Country-by-Country Reporting (CbCR).</p> <p>(8) Tax Compliance Inspection on e-commerce and digital economy industries through the resolution of international transfer pricing issues.</p> <p>(9) Taxation of Permanent Establishment (Permanent Establishment) using the rules for setting a fair transfer price, which is audited by the ATO by applying the Permanent Establishment rules based on the relevant tax treaty and following MAAL.</p> <p>(10) The Multilateral Instrument will be used to implement several recommendations of the OECD BEPS Action Plan. Including in terms of GST collection, Australia cooperates internationally in all aspects of tax administration and is one of the most important tools to ensure everyone pays the right amount of tax and protects honest businesses from unfair competition.</p> <p>(11) Hybrid mismatch rules. This rule was enacted into Australian law in August 2018. It prevents MNEs from evading income tax or obtaining double tax benefits through arrangements that exploit differences in the tax treatment of an entity or instrument in the laws of two or more tax jurisdictions.</p>
English	<p>(1) The adoption of a digital tax at a rate of 2% via nexus replaced by a significant economic presence (KES) provided that global revenues exceed £500m, and UK revenues of at least £25m, from relevant activities.</p> <p>(2) Application of Diverted Profit Tax (DPT). DPT is separate from other corporate taxes. DPT is collected at a tax rate of 25% higher than the</p>

	<p>corporate tax rate of 20% on transferred profits.</p> <p>(3) Application of General Anti Avoidance Rules (GAAR). The 2004 Finance Act and the 2005 Finance Act are the first laws to have seen several tax evasion schemes blocked earlier than expected prior to the disclosure rules.</p> <p>(4) The application of Judicial Doctrines from the experience of the IRC v Ramsay case (1981), to prevent transactions that have no commercial purpose other than to save taxes.</p> <p>(5) Implementation of Budget Note 66 (BN 66) since March 2008, to eliminate the ability of foreign trust beneficiaries to exploit double taxation treaties.</p> <p>(6) The issuance of a Fair Tax Mark certificate since 2014 as an appreciation of tax compliance and the spirit of the law.</p> <p>(7) Identification and redefinition of permanent establishments through the 2019 Finance Act to prevent the absence of permanent establishments.</p> <p>(8) Multilateral Instrument (MLI) signing. The UK has also signed the MLI. The steps included in the MLI address the four minimum standards of BEPS:</p> <ol style="list-style-type: none"> <li>handle hybrid mismatch settings (recommended in Action 2 BEPS);</li> <li>deal with abuse of agreement (Action 6 BEPS);</li> <li>addressing strategies to avoid the establishment of Permanent Establishment (Action 7 BEPS); and</li> <li>improve dispute resolution mechanisms (Action 14 BEPS).</li> </ol>
Malaysia	<p>(1) Malaysia assigns a nexus to all amounts paid or credited to non-residents considering the service regardless of where the service is performed.</p> <p>(2) Application of General Anti Avoidance Rules (GAAR). Section 140 of this 1967 ITA will identify transactions that are not commercially justified and have the sole intention of avoiding tax, as in the case of Sabah Berjaya Sdn Bhd (SB) v Chief Domestic Product Steering Committee (1999) 3 CLJ 587.</p> <p>(3) Provisions for the Imposition of Sentences for CbC since December 23, 2016.</p>

Furthermore, to understand how the absence of a nexus, which still relies on physical presence, is the reason for the absence of source jurisdiction taxation rights in digital economy taxation. It can be explained through the presence of three types of nexus:

1. *Nexus* originating from non-resident activities by establishing a permanent establishment in Indonesia;
2. *Nexus* originating from non-resident activities through the activities of related companies in the form of WPDN in Indonesia;

3. *Nexus* originating from non-residents without the presence of permanent establishments who derive their source of income from Indonesia.

It can be concluded that the *nexus* is replaced by a significant economic presence (KES –*kehadiran ekonomi signifikan*). In fact, each country unilaterally sets the transaction size or income, and the number of customers in a country. In other words, Indonesia must consider several things to determine KES for digital transactions. They are (1) limits on income from transactions related to physical goods or services carried out by non-residents in Indonesia; (2) transaction income threshold in relation to digital goods or services or property including the provision of data or software downloads by non-residents in Indonesia; and (3) threshold for the number of 'users' with whom non-population is involved in interaction or carrying out systematic and sustainable business activities in Indonesia through digital facilities.

### 3. Legal Formulation to Overcome BEPS Practices in the Indonesian Digital Economy

In the digital era, a country needs to design a suitable tax system. It is to encourage growth and investment. On the other hand, it is needed to reduce the unfair tax planning opportunities of large MNEs while innovative business models in a highly mobile digital economy is certainly not an easy job.<sup>40</sup> Of course, each tax jurisdiction country will maximize its tax revenue from this digital economy sector which is narrowed in the rules of domestic tax law, legal politics, economic politics, and international cooperation. According to the OECD, there are 5 main areas of action against BEPS:<sup>41</sup>

1. Stopping the improper transfer of profits between MNE subsidiaries in different countries;
2. Helping countries collect VAT more effectively in today's digital world;
3. Providing templates for MNEs to report, country by country, the location of their profits, sales, employees, and assets, and where they pay taxes;
4. Eliminating inter-jurisdictional treaty spending; and
5. Facilitating rapid implementation of BEPS measures through new multilateral instruments.

Furthermore, the OECD has initiated three ways to assess or replace the presence of digital permanent establishment in a jurisdiction through (1) user participation proposals; (2) marketing intangibles proposals; and (3) a proposal for a significant

<sup>40</sup> Olbert, M. and Spengel, C. "International Taxation in the Digital Economy: Challenge Accepted?", *World Tax Journal* 9, no. 1 (2017): 3–46.

<sup>41</sup> OECD, "Combating International Tax Avoidance: Ending Offshore Profit Shifting", accessed May 22, 2020, <https://www.oecd.org/about/impact/combatinginternationaltaxavoidance.htm>.

economic presence.<sup>42</sup> Previously, Indonesia still relied on the physical presence of permanent establishment. It is contained in Article 2 paragraph (4) of the Income Tax Law.<sup>43</sup> The law has not accommodated nexus without physical presence that receive income from Indonesia. In other words, it has not accommodated digital transaction taxation. In its development, Nexus has been accommodated in Law Number 11 of 2020 on Job Creation.<sup>44</sup> Article 111 has changed several articles in the Income Tax Law. Likewise, the Law Number 2 of 2020 on the Ratification of the Government Regulation in lieu of Law Number 1 of 2020<sup>45</sup> has accommodated the establishment or replacement of the presence of the permanent establishment through significant economic presence and user participation.<sup>46</sup> The regulation explicitly and clearly states that the government has requested the regulation of the digital economy taxation procedure in Indonesia to be realized in further legal regulations. However, Indonesia must always consider the dynamics of business development, technology, and tax competition among jurisdictions. Article 6 paragraph (1) b reads as follows.

*“pengenaan Pajak Penghasilan atau pajak transaksi elektronik dari kegiatan Perdagangan Melalui Sistem Elektronik (PMSE) yang dilakukan oleh Subjek pajak luar negeri yang memenuhi ketentuan kehadiran ekonomi signifikan.”*

[imposition of Income Tax or electronic transaction tax from electronic transaction activities carried out by foreign tax subjects who meet the provisions of significant economic presence.]

Furthermore, Article 6 paragraph (7) determines Significant Economic Presence through (1) consolidated gross turnover of business groups up to a certain amount; (2) sales in Indonesia with a certain amount; and/or; (3) active users of digital media in Indonesia up to a certain number.

The analysis on consideration of the nexus in India, UK, Australia, and Malaysia, the proposals outlined in Pillar 1 of the OECD, and a comparative analysis of the determination of Significant Economic Presence in several jurisdictions shows that (1) most jurisdictions have established digital tax and the rest are currently and have prepared a proposal; (2) the amount of local and global income varies greatly;

<sup>42</sup> OECD, “Addressing The Tax Challenges of The Digitalisation of The Economy”, accessed May 24, 2021, <https://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf>.

<sup>43</sup> Law Number 36 of 2008 on the Fourth Amendment to the Law Number 7 of 1983 on Income Tax.

<sup>44</sup> Law Number 11 of 2020 on Job Creation.

<sup>45</sup> Law Number 2 of 2020 on the Stipulation of Government Regulation in Lieu of Law Number 1 of 2020 on the State Financial Policy and Financial System Stability for Handling the Corona Virus Disease 2019 (COVID-19) Pandemic and/or In Facing Dangerous Threats National Economy and/or Financial System Stability.

<sup>46</sup> Government Regulation in Lieu of Law Number 1 of 2020 on the State Financial Policy and Financial System Stability for Handling the Corona Virus Disease 2019 (COVID-19) Pandemic and/or In Facing Threats That Endanger the National Economy and/or Financial System Stability.

and (3) final income tax rates vary widely but mostly range from 2%-3% of income in the source jurisdiction. Therefore, to accommodate the nexus of MNEs conducting activities or receiving income, especially in digital economic activities without a physical presence of a Permanent Establishment in Indonesia, Article 6 paragraph (7) of Law Number 2 of 2020 regulates Nexus on businesses that do not have physical presence in Indonesia.

Indonesia needs immediate implementation of digital economy taxation. It aims (1) to obtain tax revenue from the sector, which is currently not clearly regulated; (2) to maintain market balance, since there has been a tax gap and injustice between the conventional market and the online market; and (3) to ensure balanced taxation rights between jurisdictions, especially regarding the digital economy. In addition to the principle of justice, the principle of legal certainty is a fundamental principle in digital economy taxation which serves to ensure public confidence in the legal and economic consequences of actions, including online transactions. To fulfill the principle of legal certainty in collecting income tax, the determination of the taxation rights for Indonesia is the determination of tax subjects through significant economic presence based on the following norm.

*“Orang Pribadi Asing atau Badan Asing yang menjalankan usaha atau melakukan usaha (mendapatkan, menagih, bertransaksi, atau memelihara penghasilan) ke wilayah dan di wilayah hukum Indonesia melalui kehadiran fisik atau tanpa kehadiran fisik dan tanpa batasan waktu dengan penghasilan bruto paling sedikit Rp. 4,8 Miliar dalam setahun dan/atau melakukan transaksi digital minimal 500 transaksi dalam sebulan atau 6.000 transaksi dalam setahun dan/memiliki akses atau pengguna 1.000 orang per bulan atau 12.000 orang dalam setahun”*

[Foreign Individuals or Foreign Entities conducting or practicing business (earning, collecting, transacting, or maintaining income) in the territory and jurisdiction of Indonesia with or without physical presence and without time limit with a gross income of at least Rp. 4.8 billion in a year and/or make digital transactions of at least 500 transactions in a month or 6,000 transactions in a year and/have access or users of 1,000 people per month or 12,000 people in a year]

The proposal for the formulation of tax law enforcement in dealing with BEPS includes many processes and arrangements that are sustainable and still consider international consensus, including direct tax issues (pillar 1), BEPS issues, and minimum taxes and multilateral actions (pillar 2), which will be adjusted to domestic legal rules. There are several variables that must be considered in taxing digital economy transactions. First, the presence of Permanent Establishment can be replaced with an alternative significant economic presence and/or significant

digital presence. Second, taxing digital economy transactions must consider characterization of income, both active and passive. Especially for passive income, the validity of payments originating from a related relationship is important to determine whether these payments are categorized as business benefits vs. royalties, payments for copyright, payment of knowledge provision (payment of provision of know-how), or mixed payments (mixed payments). Third, the profit-sharing method between tax jurisdictions can be carried out by the profit-sharing method or the modified-profit-sharing method, or the sales-based transaction profit-sharing method, or using the new transfer price guidelines for the digital economy. Fourth, taxing digital economy transactions must increase taxation cooperation, especially audit cooperation, information exchange, and tax collection cooperation. Fifth, taxing digital economy transactions must improve tax administration with Artificial Intelligence-based information technology. Sixth, taxing digital economy transactions must increase Taxpayer Compliance by imposing strict sanctions, especially to MNEs that do not comply with tax obligations, conduct tax evasion, and tax evasion. Seventh, The Global Anti BEPS Mechanism by means of Provisions for overcoming abuse of Domestic Regulations is carried out by regulating GAAR, Anti Transfer Pricing, CFC Rules, and Thin Capitalization. On the other hand, there are also some instruments to overcome the abuse of tax treaties. They are (1) Multilateral Instrument (MLI), (2) Determination of Beneficial Ownership, (3) Principle Purpose Test (PPT), and (4) Simplified Limitation on Benefits (LoB).

### C. Conclusion

Mostly, the MNEs use three techniques of the BEPS to avoid taxes in the digital economy business: (1) using Permanent Establishments in low-tax jurisdictions or non-tax jurisdictions; (2) transfer pricing through entities that have a special relationship to reduce tax obligations in the source country; and (3) tax treaty shopping to tax jurisdictions that provide significant tax benefits.

India, Australia, Britain, and Malaysia deal with MNEs with BEPS in the digital economy by employing some strategies. Firstly, all jurisdictions unilaterally develop and amend laws and regulations, in particular the Income Tax Law, and the Finance Law. They also realize the collection of VAT, as well as carry out various legal efforts to prevent and overcome BEPS. Secondly, India, United Kingdom, and Australia unilaterally establish a Significant Economic Presence to replace the presence of the Permanent Establishment. Thirdly, all jurisdictions carry out international cooperation, both bilaterally and multilaterally, which is realized through tax treaties, MLI and CbC reporting. Fourthly, all research jurisdictions develop anti-tax evasion laws through GAAR and SAAR. Fifthly, Australia and the United Kingdom develop a Diverted Profit Tax (DPT) system and conduct investigations of inter-jurisdictional payment traffic.



Indonesia should have created legal formulation to overcome BEPS practices in the digital economy. First, Indonesia must unilaterally determine the legal subject of Permanent Establishment to be replaced by using the principle of Significant Economic Presence. Second, the application of digital economy VAT can be done in two ways: (1) Final VAT application with a final rate of 2-3% of gross circulation; or (2) application of Non-Final Income Tax that follows the territoriality principle in accordance with Taxable Income (Article 16 of the Income Tax Law) with the rate of Income Tax Article 17 paragraph 1 letter b and following changes in tax rates as regulated in Article 5 of Law Number 2 of 2020. Third, Indonesia can carry out the application of the Global Anti -BEPS mechanism by strengthening and improving the provisions for overcoming domestic rules by regulating GAAR and SAAR (Anti Transfer Pricing, CFC Rules, and Thin Capitalization).

Thus, it is important to validate the legal concept of the Digital Permanent Establishment to provide terminology and new legal discoveries regarding the concept of Permanent Establishment which have been detrimental to the Source Country (Indonesia) but benefit the Domicile Country. Moreover, to avoid the possibility of difficulty in agreement or global consensus on digital economy taxation, Indonesia can apply final income tax with a tax rate in the range of 1-3% due to the simplicity of the procedure.

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