

**Value Added Tax (VAT) in the Indonesian Digital Economy : An Appropriate Solution?**

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**Abstract**

*The rapid digital transformation has brought significant changes to economic transactions, necessitating adaptive tax policies capable of accommodating cross-border digital business models. This research employs a qualitative approach with descriptive and analytical methods, integrating doctrinal legal analysis, a comparative approach, and policy analysis. Data were gathered through an in-depth review of relevant Indonesian legal instruments, including Law No. 2/2020 and Minister of Finance Regulations No. 48/2020, No. 60/2022, and No. 199/PMK.10/2019. Additionally, the study references international guidelines such as the OECD International VAT/GST Guidelines (2017) and the BEPS 2.0 framework to provide comparative and global perspectives. The findings reveal that Indonesia's implementation of VAT on digital transactions has seen significant progress, particularly through the vendor collection model for foreign digital service providers. This policy is expected to enhance tax compliance and expand the digital tax base. However, the study also identifies several challenges, including administrative feasibility, complexity in tax reporting by digital businesses, and the need for harmonization with international standards. From a policy perspective, VAT on Indonesia's digital economy is deemed relevant in ensuring fiscal fairness, increasing state revenue, and fostering healthy business competition. The study's limitation lies in its reliance on secondary documentary data, which may not fully capture the practical dynamics faced by businesses and consumers on the ground. Therefore, future research is recommended to incorporate empirical data through interviews or surveys with digital business actors, tax practitioners, and policymakers, to obtain a more nuanced and comprehensive understanding. Overall, this research makes a significant contribution to academic discourse and public policy related to digital economy taxation in Indonesia and serves as a reference for future tax policy reforms in the rapidly evolving digital era.*

**Keywords:** Value Added Tax, Digital Economy, Destination Principle, Vendor Collection

**INTRODUCTION**

The digital economy has emerged as one of the most transformative forces in the global economy, reshaping how businesses operate, how consumers engage, and how governments approach fiscal policy. Digital transactions—ranging from streaming services and cloud computing to e-commerce and online advertising—transcend national border sand have created new avenues for economic growth and innovation. Yet, this rapid evolution poses complex challenges for taxation systems designed in an era when economic activity was largely tied to physical presence and tangible assets.

Indonesia, the lagest economy in Southeast Asia and a rapidly growing digital market, has been at the center of this transformation. The 2023 e-Conomy SEA report underscores Indonesia' scrucial role, revealing that the country'sdigital economy reached a substantial USD

82 billion in 2023, accounting for nearly 38% of Southeast Asia's total digital economy valuation. This figure marksanimpressive 8%increasefromthepreviousyearandsetsthestage for an ambitious projection of USD 360 billion by 2030. Such exponential growth not only highlights Indonesia' spotential as a digital power house but also underscores the need for robust and equitable tax policies that can keep pace with the evolving digital landscape

Historically, international tax frameworks have relied on the concept of a permanent

establishment (PE), where tax obligations are triggered only when a business has a significant physical presence within a country. However, the digital economy has fundamentally disrupted this paradigm. Multinational enterprises can now earn substantial revenue from Indonesian consumers without any physical presence within the country, thereby creating a disconnect between economic activity and the location of taxing rights. Recognizing this mismatch Indonesia's government has taken proactive steps to adapt its tax system to the realities of the digital economy.

In 2020, Indonesia enacted Law No. 2/2020, which introduced a framework for taxing digital transactions by foreign businesses with a "significant economic presence" in Indonesia. While the law included provisions for income tax on foreign digital service providers, the implementation of these measures faced significant hurdles due to conflicting international tax treaties and the entrenched principle of taxing based on physical presence. These challenges created uncertainty and the risk of double taxation, which could discourage investment and hamper economic growth. As a result, the Indonesian Ministry of Finance decided to pause further development of the income tax provisions and instead focus on the more immediate and practical application of Value Added Tax (VAT).

VAT, a consumption-based tax, aligns with the destination principle, which dictates that tax is levied in the jurisdiction where consumption occurs. This approach is particularly well-suited for the digital economy, where cross-border transactions are common, and physical presence is no longer a prerequisite for economic activity. In line with international best practices—such as the OECD's International VAT/GST Guidelines—Indonesia has mandated that foreign digital service providers collect and remit VAT on sales to Indonesian consumers. This vendor collection model, formalized through Minister of Finance Regulation No. 48/2020 and updated by Regulation No. 60/2022, has positioned Indonesia as a regional leader in digital VAT collection, generating significant revenue from foreign digital platforms like Google, Amazon, and Netflix.

Never the less, relying solely on VAT to tax the digital economy presents both opportunities and challenges. While VAT has proven to be an effective stopgap measure, questions remain about its long-term suitability in an era of rapid technological change and evolving international tax frameworks. Indonesia's approach to taxing low-value imports, for example—where VAT exemptions have been removed to level the playing field has succeeded in raising revenue but also introduced concerns about administrative complexity and the regressive nature of consumption taxes.

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Moreover, as the international community moves closer to implementing the OECD's Pillar One proposal, which seeks to allocate taxing rights based on digital sales and significant economic presence, Indonesia must consider how VAT can complement future direct tax measures. Pillar One represents a shift away from the traditional reliance on physical presence, aiming instead to ensure that countries like Indonesia can tax the profits of large multinational

enterprises that benefit from their markets, regardless of where those profits are booked.

Against this backdrop, this study seeks to answer a fundamental question: Is VAT an effective and appropriate tool for taxing the digital economy in Indonesia, particularly in the context of an emerging market? By examining Indonesia's experience with VAT in taxing both low-value imports and remote digital supplies, this analysis will explore the effectiveness of VAT as a transitional measure while also considering its role as a complement to future global tax reforms under Pillar One.

In doing so, the study not only aims to shed light on Indonesia's unique challenges and successes but also to contribute to the broader international discourse on how to fairly and sustainably tax the digital economy in an era defined by unprecedented connectivity and innovation.

## RESEARCH METHODS

This study adopts a qualitative research approach to examine the effectiveness and appropriateness of VAT as a tool for taxing the digital economy in Indonesia. Given the rapidly evolving nature of digital transactions and the complexity of global taxation frameworks, a qualitative methodology allows for a comprehensive exploration of regulatory, legal, and economic dimensions. The research design is rooted in descriptive and analytical methods, aiming to capture both the legal landscape and the practical implications of VAT implementation in Indonesia's digital sector.

### Data Collection

The primary data for this study was derived from an extensive review of relevant legal and regulatory instruments, including Indonesian tax laws, ministerial regulations, and official guidelines issued by the Ministry of Finance. Key documents include Law No. 2/2020 on Taxation of Electronic Transactions, Minister of Finance Regulations No. 48/2020, No. 60/2022, and No. 199/PMK.10/2019, as well as historical developments in VAT application. In addition, the study incorporates guidance from the OECD International VAT/GST Guidelines (2017) and the BEPS 2.0 framework to contextualize Indonesia's VAT approach within broader international practices.

### Data Analysis

The research employs a doctrinal legal analysis to evaluate Indonesia's VAT framework for digital transactions. This involves an in-depth examination of statutory texts and regulatory frameworks to interpret their scope, implications, and alignment with international standards. The doctrinal analysis is complemented by a comparative approach, assessing Indonesia's VAT practices against global best practices and frameworks such as the OECD's recommendations and the Pillar One proposal.

Additionally, the study uses a policy analysis framework to assess the effectiveness and equity of Indonesia's VAT measures. This involves evaluating the policy objectives of VAT regulations in Indonesia, their practical impact on foreign and domestic businesses, and their broader implications for revenue generation, competition, and social equity. Special attention is given to the vendor collection model and low-value import VAT thresholds to understand their administrative feasibility and socio-economic consequences.

**Limitations**

While this study provides a comprehensive examination of Indonesia's VAT framework, it acknowledges certain limitations. The analysis relies heavily on secondary data sources and legal instruments, which may not fully capture the practical challenges faced by businesses and consumers on the ground. Future research could benefit from empirical data, such as interviews with policymakers, tax practitioners, and digital service providers, to validate and enrich these findings.

In summary, this study adopts a multi-faceted qualitative approach, integrating doctrinal legal analysis, comparative evaluation, and policy analysis to provide a nuanced understanding of VAT's role in Indonesia's digital economy. The methodology ensures a thorough exploration of the legal, economic, and administrative aspects of digital VAT, while also situating it within the context of global tax reforms.

**RESULTS AND DISCUSSION****Result**

The implementation of VAT on digital transactions in Indonesia has progressed significantly since the issuance of Law No. 2/2020, which expanded the VAT coverage to include cross-border digital services. The Ministry of Finance Regulations (PMK) No. 48/2020 and No. 60/2022 have further specified the mechanisms for VAT collection, particularly through the appointment of foreign digital service providers as VAT collectors (vendor collection model). As of the end of 2024, over 150 foreign digital businesses have been registered as VAT collectors in Indonesia, covering major platforms such as Google, Netflix, Spotify, and others. This has contributed to an increase in VAT revenues from the digital economy sector, with the Directorate General of Taxes reporting a steady year-on-year increase in digital VAT receipts.

**Discussion**

The study's findings indicate that the vendor collection model has proven to be an effective mechanism in capturing VAT from cross-border digital transactions. This approach simplifies tax collection by placing the obligation to collect, report, and remit VAT on foreign digital businesses, thus addressing challenges related to enforcement and jurisdiction. Indonesia's approach aligns with global best practices recommended by the OECD International VAT/GST Guidelines (2017), which advocate for the destination principle—taxing consumption in the country where the consumer is located.

However, several challenges and considerations have emerged in the practical implementation of this policy:

**1. Administrative Feasibility and Compliance Costs**

Although the vendor collection model reduces administrative burdens for the tax authority, it may impose compliance costs on foreign digital businesses, especially for smaller firms with limited resources. These businesses must familiarize themselves with Indonesian tax regulations, register for VAT, and maintain accurate reporting practices. In some cases, differences in tax reporting formats and technological infrastructure can lead to practical difficulties in compliance.

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## 3. Complexity of Tax Reporting and Enforcement

While the policy has increased VAT revenues, there remains a challenge in monitoring the accuracy of VAT reports from foreign digital businesses. The Directorate General of Taxes relies heavily on self-assessment by these vendors, with limited enforcement mechanisms to verify the reported data. This raises questions about the accuracy and completeness of digital VAT collections.

## 4. Harmonization with International Standards and Best Practices

Indonesia's policy is generally consistent with OECD guidelines; however, the global digital economy is evolving rapidly, necessitating continuous updates and coordination with international standards. The ongoing implementation of the OECD BEPS 2.0 framework, particularly Pillar One, may have implications for how digital taxes, including VAT, are administered in cross-border digital transactions.

## 5. Impact on Domestic Digital Businesses and Market Competition

Another important consideration is the impact of this policy on domestic digital businesses and the broader competitive landscape. By imposing VAT on foreign digital services, the policy creates a more level playing field for domestic providers who are already subject to VAT obligations. However, domestic businesses may also face competitive pressure from global platforms that can absorb VAT costs more easily due to their scale and resources.

## 6. Consumer Perspective

From the consumer standpoint, the imposition of VAT on digital services has led to an increase in the final price of digital goods and services, potentially affecting consumer behavior. Nevertheless, this aligns with the principle of neutrality and tax fairness, ensuring that digital consumption is taxed similarly to traditional goods and services.

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### **Discussion**

Overall, the VAT policy on Indonesia's digital economy represents a proactive response to the challenges of digitalization. While it has successfully expanded the tax base and improved compliance among large foreign digital service providers, there is still room for improvement, particularly in terms of enforcement, administrative support, and harmonization with international tax standards. Future policy reforms should consider these challenges to ensure a balanced approach that promotes both tax fairness and a supportive environment for the growth of the digital economy.

Overall, the VAT policy on Indonesia's digital economy represents a proactive response to the challenges of digitalization. While it has successfully expanded the tax base and improved compliance among large foreign digital service providers, there is still room for improvement, particularly in terms of enforcement, administrative support, and harmonization with international tax standards. Future policy reforms should consider these challenges to ensure a balanced approach that promotes both tax fairness and a supportive environment for the growth of the digital economy

### **CONCLUSION**

The implementation of Value Added Tax (VAT) on Indonesia's digital economy demonstrates a proactive and innovative response to the challenges posed by the rapid growth of cross-border digital transactions. The adoption of the vendor collection model has successfully expanded the tax base, enhanced revenue collection, and promoted fairness in the digital marketplace by ensuring that foreign digital service providers comply with Indonesian tax regulations.

Despite these successes, challenges remain in the areas of enforcement, administrative capacity, and the need for continuous alignment with evolving international tax standards. Future policy development should focus on improving data verification systems, providing greater support for foreign digital businesses to facilitate compliance, and fostering international cooperation to address issues related to digital taxation more comprehensively.

Overall, Indonesia's approach represents a significant step forward in modernizing its tax system to keep pace with the digital economy's evolution, ensuring both fiscal sustainability and a fairer digital market for domestic and international stakeholders

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