

A Critical Review on Challenges of Implementing E-Commerce Taxation in Indonesia

**Agung NLI Fahrudi, Onni Meirezaldi, Kartika Putri Kumalasari, Nurlita Sukma
Alfandia**

Faculty of Administrative Science, Universitas Brawajaya, Malang, East Jawa, Indonesia

Corresponding email address: agungn_fia@ub.ac.id

Abstract

E-commerce has been growing rapidly across the globe due to the benefits that it offers, such as shopping without the need of physical presence and available 24/7. The increasing usage of internet worldwide has contributed to the development of e-commerce. Taxation of e-commerce has become an important issue because the potential government income from Value Added Tax or Income Tax of e-commerce transactions. However, e-commerce poses new challenges for taxation enforcement. Based on existing literatures, it is found that common problems of e-commerce taxation in Indonesia include tax avoidance and tax evasion, double taxation, permanent establishment requirements, and transfer pricing. Some efforts have been taken by the Indonesian government to address these problems but there are still areas for improvements to close the taxation gap. The result of this study can be used to inform policy makers and stakeholders in improving the implementation of e-commerce taxation.

Keywords: E-Commerce, Tax Policy, Digital Taxation, Developing Countries

Introduction

E-commerce is defined as the trade of goods or services via computer networks using specific methods intended for receiving or placing orders (OECD, 2019). It offers advantages, such as shopping without the need of physical presence and available 24 hours within a week (Yapar et al., 2015). Online platforms allow smaller businesses to access a global marketplace efficiently, reaching million customers over a wide range of territory with relatively low operational costs (Scarcella, 2020). E-commerce involves a range of different commercial relationships between consumers, businesses, and government (OECD, 2019). For instance, Business to Business (B2B) is a type of commercial relationships between companies, such as Drop shipping. In Business to Consumer (B2C) relationship, businesses sell goods or services to consumers, such as Amazon, in which seller and customers can interact with each other directly. In Consumer to Business (C2B), companies can bid on the project offered by consumers, such as Elance. There is also peer to peer relationships or Consumer to Consumer (C2C) in which online trades occurs between consumers or individuals, such as eBay (Hartanto, 2020).

Along with the increasing internet usage across the world, e-commerce has been growing rapidly (Yapar et al., 2015). Based on Coppolla (2021), online retail sales worldwide have exceeded USD 4.28 trillion in 2020. In Indonesia, a total e-commerce transaction of 180 trillion rupiahs has been realized by August 2020 and it is estimated to reach 429 trillion rupiahs throughout 2020 (Damuri, 2021). During the pandemic, where social distancing norms are being applied, e-commerce transactions has significantly increased in which new digital consumers in Indonesia has risen 37 percent (Google, Temasek, Bain & Company, 2020). The

growth of e-commerce transactions will increase potential government revenue through taxation from e-commerce transactions (Hartanto, 2020).

E-commerce taxation can be imposed on consumption or income tax (OECD, 2014). In the one hand, consumption taxes (i.e., Value Added Tax) are levied on expenditure related to the consumptions of goods and services at the time of the transaction and at the place of destination. For example, VAT can be taxed at the importing country when e-commerce transactions occur. On the other hand, income taxes are imposed on net income over an annual tax period at the place of source of income.

However, e-commerce poses new challenges for taxation enforcement like a higher risk of tax loss and tax evasion (Yapar et al., 2015). VAT regulations have been initially created based on the physical world features so that new mechanisms are needed to improve their enforcement in an online arena. For example, double taxation may occur in which seller may have to pay e-commerce tax in multiple countries (Scarcella, 2020). While e-commerce tax can potentially offer government income, the implementation of e-commerce tax faces many challenges in Indonesia (Hartanto, 2020). Furthermore, there is a debate regarding the negative impacts of e-commerce tax to small businesses (Uzuner & McKnight, 2001). In addition, the adoption of e-commerce among small medium enterprises are still limited (Zain, Juzoh, Munir and Putit, 2020; Rahayu and Day, 2017). As such, better understanding of e-commerce taxation challenges in Indonesia is needed to solve these problems and ultimately obtain the potential benefits of e-commerce tax without hampering the digital economic growth. This study aims to investigate e-commerce taxation challenges in Indonesia and what have been done to solve these problems based on existing literatures. The result of this study can be used to inform policy makers and stakeholders in improving the implementation of e-commerce taxation. The implementation of e-commerce tax in Indonesia can also offers insights for other countries with similar conditions to improve the implementation of their e-commerce taxation. This study will discuss the role of e-commerce taxation, implementation of e-commerce taxation in Indonesia, and the problems of e-commerce taxation as well as the efforts that have been taken by the Indonesian government to address these problems.

Literature Review

The Role of E-Commerce Taxation

There are two main reasons for applying tax to e-commerce transactions. First, the significant growth of e-commerce transactions offers the potential government income through e-commerce taxation (Yapar et al., 2015). If governments fail to tax e-commerce sales, significant revenues will also be lost. When governments face increasing expenditures and decreasing revenues, the need for raising revenue through finding a new source of government income (i.e., e-commerce tax) will be increasingly important as they need to finance public goods. Second, e-commerce taxation is required for creating a level-playing field for both conventional and e-commerce businesses (Hartanto, 2020). The absence of e-commerce tax will benefit e-commerce businesses in which they will be able to offer lower prices due to non-taxed products or services. As such equity needs to be considered in developing e-commerce taxation systems.

Equity consists of two main aspects: horizontal and vertical equity (OECD, 2014). Horizontal equity means that a similar tax burden should be given to taxpayers in similar economic conditions. In contrast, vertical equity suggests that taxpayers who have better abilities to pay more taxes should contribute more tax burden proportionally to their income. In addition, inter-nation equity which concerns with the allocation of national gain and loss in the context of international business is required to achieve a fair sharing of e-commerce tax revenues from cross-border sales (OECD, 2001).

However, there is also a growing concern about the negative effects of imposing e-commerce tax to small businesses (Uzuner & McKnight, 2001). E-commerce have enabled smaller businesses to reach consumers located in a wider territory efficiently. Nevertheless, e-commerce tax may discourage small businesses to adopt e-commerce and therefore create losses for the economy. Setiawan et al. (2019) state that developing countries tend to apply tax holiday for e-commerce transactions to promote further adoption of e-commerce. According to Rahayu and Day (2017), majority of small medium enterprises in Indonesia are still in the early stage of e-commerce adoption in which most of them only have simple websites and some of them even only have e-mail. As such, small entrepreneurs may need to be excluded from e-commerce taxation to give them opportunities to grow (Damuri et al., 2021). Governments should consider the pros and cons of implementing e-commerce taxation so that they can reap the benefits of e-commerce taxation without discouraging digital economic growth.

Research Methodology

This study adopted a qualitative literature review. Peer-reviewed journal articles, like from ScienceDirect journals and other relevant sources, were used for analysis in this study. The selection of articles used relevant keywords, such as, e-commerce, taxation, and challenges. The relevant articles were taken from international journals written in English and Indonesian journal written in Bahasa Indonesia. Grey literatures were also used to provide additional information so that a complete picture of existing e-commerce tax implementation in Indonesia can be obtained.

Results and Findings

Implementation of E-Commerce Taxation in Indonesia

Based on the Directorate General of Taxation Circular No 62 Year 2013, there are four types of e-commerce transactions: online marketplace, classified ads, daily deals, and online retails (Directorate General of Taxation, 2013). Online marketplace is the activity of providing a place for online stores to sell goods or services. Classified ads are the activities of providing a place to display advertisements on web sites. Daily deals are the activities of providing a place for online stores to sell goods or services using vouchers as means of payments. Online retails are the activities of selling goods or services directly to buyers through online retail sites owned by the sellers.

E-commerce taxation can be imposed through Income Tax and Value Added Tax. In the one hand, Income Tax is levied based on the Government Regulation No 23 Year 2018 in which e-commerce taxpayers who earn less than 4.8 billion rupiahs annually will be subject to 0.5% final income tax. For those who earn more than 4.8 billion rupiahs must pay the general tax rate of 25%. On the other hand, Value Added Tax is charged based on the Value Added Tax on Goods and Services and Sales Tax on Luxury Goods Law No 42 Year 2009. The general tax rate for VAT is 10% while the tax rate for luxury goods range between 10% and 200%. In addition, VAT taxable enterprises are those making sales more than 4.8 billion rupiahs per year.

In 2018, the Ministry of Finance Regulation (PMK) No 210 Year 2018 was released to deal with e-commerce tax. It was similar with other taxes imposed to conventional businesses, but the difference was the collecting mechanism (Fitriandi, 2020). Previously, VAT was collected by the trader but under this regulation it was supposed to be collected by the online platform provider. By appointing online platforms or e-commerce marketplaces as a third party for assessing and collecting e-commerce tax, it would be easier for the government to manage e-commerce tax because the online platforms have access to relevant information related e-commerce sales in their platforms. However, it was cancelled with the issuance of the Minister of Finance Regulation No 31 Year 2019. The e-commerce tax might negatively affect the

adoption of digital technology among small medium enterprises (Setiawan, 2019). At this stage, the government wanted to focus on facilitating the digital economic growth and encouraging small medium enterprises to adopt digital technologies. In addition, the government would like to take additional time to socialize e-commerce tax so that taxpayers would be aware of the e-commerce regulations. Previous research has shown that one of the causes for the resistance toward the e-commerce regulations in Indonesia was lack of socialization (Hartanto, 2020; Setiawan, 2019). Furthermore, taxation professionals were in the opinion that the taxation systems were not ready yet and the taxation staff's technology skills related to big data technology were not sufficient yet (Setiawan, 2019). Big Data technology is required to analyse and supervise tax revenue (Huang et al., 2018). As such, the government tried to carefully consider the right sequencing and transition in implementing e-commerce tax.

In 2020, as an initial step of implementing e-commerce tax, the government has started taxing digital technology companies with no physical presence in Indonesia through the issuance of the Government Regulation in Lieu of Law (Perpu) No 1 Year 2020. To implement this new regulation, the Minister of Finance Regulation (PMK) No 48 Year 2020 was issued to regulate the tax rate of digital products VAT which is 10 percent. VAT collectors are appointed by the government to collect 10 percent VAT from the foreign goods and services they sell under the new digital tax. According to Directorate General of Taxation Regulation No 12 Year 2020, VAT collectors are digital services providers that generate minimum annual sales of 600 million rupiahs or 50 million rupiahs per month, and/or have a user base of at least 12,000 annually or 1,000 in a month in Indonesia. For e-marketplace platforms, the e-marketplace providers will be responsible to collect the digital goods VAT.

Problem of E-Commerce Taxation

There are also some major problems in implementing e-commerce taxation in Indonesia. These problems include tax avoidance and tax evasion, double taxation, permanent establishment, and transfer pricing issues as shown in Table 1. First, tax avoidance and tax evasion are common problems in the implementation of e-commerce taxation due to the difficulties in identifying the tax base and then enforcing the tax (Basu, 2008). It is often difficult to detect e-commerce transactions, especially for digital products. In virtual environment, it is also difficult to trace personal or corporate identity. In addition, it is also not easy to locate sellers and buyers who involve in e-commerce transactions. As a result, the country's authorities can hardly collect information about taxes so that tax loss may occur. According to Scarcella (2020), this problem can be minimised by appointing online platforms or e-commerce marketplaces as a third party for assessing and collecting e-commerce tax because they have access to relevant information related e-commerce transactions occurring in their platforms. Therefore, the government of Indonesia has also collaborated with online platforms to collect e-commerce tax. In addition, the taxation staff's technology skills need to be improved since they will deal with a lot of digital data. The government also need to socialize e-commerce tax since the regulation is relatively new (Hartanto, 2020).

Table 1: E-Commerce Taxation Challenges

Problems	Causes	Solutions
Tax avoidance and tax evasion	Difficulties in identifying the tax base and enforcing the tax	<ol style="list-style-type: none"> 1. Appointing online platforms of e-commerce marketplaces as a third party for assessing and collecting e-commerce tax. 2. Upgrading the taxation staff's technology skills in dealing with digital data 3. Socializing e-commerce tax as the regulation is relatively new in Indonesia
Double taxation	Two or more jurisdictions collect taxation on the same source of income	<ol style="list-style-type: none"> 1. Obtaining tax treaties that allocate taxing rights to the contracting states 2. More Double Tax Avoidance Agreement are required in Indonesia
Permanent Establishment (PE)	The requirement for physical presence	Expanding the criteria for PE by including the significant economic presence aspect (the Indonesian Government Regulation in Lieu of Law (Perpu) No 1 Year 2020)
Transfer pricing	Multinational companies report their income in low-tax jurisdictions and not in the economic activities happen in order to avoid tax	<ol style="list-style-type: none"> 1. BEPS actions, specifically Actions 8-10 related to transfer pricing 2. Advance pricing agreement (Ministry of Finance Regulation No 22 Year 2020)

Second, double taxation, where tax burden is given by two or more jurisdictions on the same source of income, can also happen in the implementation of cross-border e-commerce tax. According to OECD (2014), this problem can be solved by bilateral tax treaties that allocate taxing rights to the contracting states. In general, these treaties should address: (a) the tax treaty's scope and application, (b) the conflict of taxing jurisdiction, (c) double taxation relief, (d) the prevention of tax avoidance and fiscal evasion, and (e) miscellaneous matters like administrative assistance (OECD, 2014 p. 36). Currently, Indonesia still has 70 Double Tax Avoidance Agreement (DTA) partners (Ministry of Finance, 2020) and there are still high risks of double taxation with countries that have not got DTA. Double taxation needs to be eliminated because it can hinder the growth of international economic cooperation (Radu, 2012).

Third, the Permanent Establishment (PE) requirements are often used by foreign e-commerce taxpayers to avoid paying tax (Yapar et al., 2015). In 2020, the Government of Indonesia issued the Government Regulation in Lieu of Law (Perpu) No 1 Year 2020 to expand

the criteria for Permanent Establishments by including the significant economic presence aspect. As such, digital technology companies domiciled abroad will still need to pay income tax although they do not have a physical office in Indonesia because they get significant incomes from consumers in Indonesia. According to OECD (2021), there was an existence of base erosion and profit shifting (BEPS) practiced by multinational companies in which there was a mismatch between the location where income was reported and the location where the economic activities happened.

Lastly, transfer pricing can also be used to avoid tax by multinational companies (Barker et al., 2017). Using transfer pricing, corporations domiciled in high-tax jurisdictions can sell goods or services to partners in the low-tax jurisdictions at cheaper prices to decrease revenues for the company in the high-tax jurisdiction and to increase revenues and profits for the company in the low-tax jurisdiction. In addition, the company in the high-tax jurisdiction can buy goods or services from partners in the low-tax jurisdiction at higher prices to increase expenses and lead to lower taxable incomes. OECD (2019) has recommended BEPS actions, specifically Action 8-10 related to transfer pricing, that provide the guidance on the arm's length principle. These principal mandates that the price of transaction between two related parties should be equal to a transaction conducted by two unrelated parties on the open market. The government of Indonesia has issued the Ministry of Finance Regulation (PMK) No 22 Year 2020 about advance pricing agreement to deal with transfer pricing issues. However, the effectiveness of the existing regulation to prevent tax avoidance remains to be proven due to the complexity of electronic transfer pricing activities (Abdallah, 2002). While some efforts have been done by the government to close the taxation gap in the implementation of e-commerce taxation in Indonesia, there are still many other weaknesses in existing e-commerce regulation that can be used by e-commerce taxpayers to avoid paying tax.

Discussion and Conclusion

The rapid growth of e-commerce in Indonesia offers the potential government income through e-commerce taxation. In addition, the e-commerce taxation is needed to create a level-playing field for both conventional and e-commerce businesses. However, the implementation of e-commerce taxation should not undermine the digital economic growth. Many small business actors are still in their early stage of digital platform adoption so that the e-commerce taxation is not supposed to increase entry barriers for them. As such, small entrepreneurs may need to be given tax relief to enable them to grow first. At this stage, the government focuses on facilitating the digital economic growth and encouraging small medium enterprises to adopt digital technologies. While the implementation of e-commerce tax is important, the right sequencing and transition should be carefully managed.

As an initial step, the government has started taxing digital technology companies with no physical presence in Indonesia. The implementation of e-commerce taxation in Indonesia also faces many challenges, such as tax avoidance and tax evasion, double taxation, permanent establishment, and transfer pricing. Some efforts have been taken to address these problems. For example, the government has collaborated with third party agencies to collect e-commerce tax. The government has also made double taxation avoidance agreement with several countries and has been trying to make more agreements with the other countries which have not had agreement yet. In addition, the government has expanded the criteria of Permanent Establishment by including the significant economic presence aspect. Furthermore, the government has also issued regulations regarding advance pricing agreement to deal with transfer pricing issues. Although the government has taken some initiatives to close the taxation gap, there are still many loopholes in the regulation that can be used by taxpayers to avoid paying tax.

Further research may investigate deeper into each taxation problem and find the solutions to close the taxation gap. In addition, the taxation staff's readiness in adopting big data technology should also be considered in implementing more complex e-commerce tax management, especially in developing countries. The government should also sufficiently socialize e-commerce regulations before their implementation to avoid resistance from the stakeholders.

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