



## The Analysis of Indonesian Electronic Transaction Tax (ETT) Under WTO Law

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**Abstract.** *The existing international tax system, which is regulated by two fundamental principles—source- and residence-based principle, is no longer adequate for regulating corporate and digital service taxation. Act No. 2 of 2020 provides a legal basis for the imposition of Electronic Transaction Tax (ETT) on electronic commerce conducted by foreign merchants, foreign service providers, and/or foreign trade, which meet the provisions of having a significant economic presence such as Google, Amazon, Facebook, and Apple (GAFA). With the unilateral measure by Indonesia, it can be considered as having created a new tax policy outside the tax treaty and becoming an issue of a trade war between countries. Regarding Indonesia's GATS obligations, there is potential for an ETT to violate the obligations of national treatment and MFN. However, such tax can be justified under available exceptions in GATS if Indonesia conducts certain legal adjustments on ETT design.*

**Keywords:** *Obligation; Online; Transaction.*

### 1. Introduction

The advancement of technology has brought unprecedented global economic changes. At the same time, the Internet has boosted innovation and promoted a new model of business around the world, moving away from a brick-and-mortar business model toward a more digitalized economy without establishing a physical presence.<sup>1</sup> Hence, the existing international tax system, which is regulated by two fundamental

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<sup>1</sup> J Bankman, O Alan, and M Kane, "Collecting the Rent: The Global Battle to Capture MNE Profits," *Tax Law Review* 72 (2020): 2, <https://law.stanford.edu/publications/collecting-the-rent-the-global-battle-to-capture-mne-profits/>.

principles—source- and residence-based principle,<sup>2</sup> is no longer suitable for regulating corporate and digital service taxation.<sup>3</sup> However, source countries are unable to impose domestic income taxes on various digital companies abroad, therefore, generating income from their countries due to the lack of a Permanent Establishment (PE).<sup>4</sup> Google, Amazon, Facebook, and Apple (GAFA) are among the best-known digital service providers in the world for their size of businesses.

Although the participating countries of the Organization for Economic Co-operation and Development (OECD), Group of 20 (G20), and Inclusive Framework on Base Erosion and Profit Shifting (BEPS) confirmed their commitment to achieving a multilateral solution by the end of 2020. However, at the end of 2020, the OECD, G20, and Inclusive Framework on BEPS failed to achieve a global consensus on time and acknowledged that there are still political differences and technical issues incorporating digital taxation.<sup>5</sup> Nevertheless, despite the progress made at the multilateral level, many countries have unilaterally proposed and implemented Digital Services Tax (DST) or other similar tax measures to fill in the loophole of the international tax system<sup>6</sup> and to hold the Global Digital Giants (which includes GAFA) accountable for the vast number of profits they make by collecting and exploiting user data from the market countries.<sup>7</sup>

Following the outbreak of the COVID-19 pandemic<sup>8</sup>, Indonesia enacted Government Regulation in place of Act No. 1 of 2020, which was subsequently approved by the Indonesian House of Representatives to become Act No. 2 of 2020 on May 18, 2020,

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<sup>2</sup> Brian J Arnold, *International Tax Primer*, Third (Alphen aan den Rijn: Wolters Kluwer, 2016), 3.

<sup>3</sup> OECD, *Tax Challenges Arising from Digitalisation - Interim Report 2018 OECD/G20 Base Erosion and Profit Shifting Project* (Paris: OECD Publishing, 2018), <https://doi.org/https://doi.org/http://dx.doi.org/10.1787/9789264293083-en>.

<sup>4</sup> OECD, *Model Tax Convention on Income and on Capital 2017 (Full Version)* (Paris: OECD Publishing, 2017), <https://doi.org/https://doi.org/https://doi.org/10.1787/g2g972ee-en>.

<sup>5</sup> OECD, "Cover Statement by the OECD/G20 Inclusive Framework on BEPS on the Reports on the Blueprints of Pillar One and Pillar Two" (Paris, 2020), <https://doi.org/10.1787/9689d12e-en>.

<sup>6</sup> Putri Anggia, "The Influence of International Tax Policy on the Indonesian Tax Law," *Yuridika* 35, no. 2 (2019): 347, <https://doi.org/10.20473/ydk.v35i2.16873>.

<sup>7</sup> There are 26 countries enacted in their legislation inter alia: Argentina, Austria, India, Indonesia, Italy, Spain, the United Kingdom, and Turkey; 4 countries with draft legislation or public consultation such as Brazil, Czech Republic, and Slovakia; 11 countries have announced their intentions to implement, such as Canada, Denmark, Japan, and Russia. See KPMG, "Taxation of the Digitalized Economy: Developments Summary (Update 31 March 2021)," [kpmg.com](https://tax.kpmg.us/content/dam/tax/en/pdfs/2021/digitalized-economy-taxation-developments-summary.pdf), 2021, <https://tax.kpmg.us/content/dam/tax/en/pdfs/2021/digitalized-economy-taxation-developments-summary.pdf>.

<sup>8</sup> Nima Norouzi and Elham Ataei, "Covid-19 Crisis and Environmental Law: Opportunities and Challenges," *Hasanuddin Law Review* 7, no. 1 (2021): 1, <https://doi.org/10.20956/halrev.v7i1.2772>.

to address state financial stability.<sup>9</sup> Consequently, Act No. 2 of 2020 provides a legal basis for the imposition of income tax or Electronic Transaction Tax (ETT) on electronic commerce conducted by foreign merchants, foreign service providers, and/or foreign trade through Electronic System Organizers (hereinafter "non-tax resident subject") that meet the provisions of having a significant economic presence.<sup>10</sup> Non-tax resident subjects, both directly and through foreign Ecommerce like the Trading Through Electronic System (TTES) Operators that satisfy the provisions on significant economic presence, can be treated as PE and be subject to Income Tax.

Furthermore, under Article 6 paragraph 8 of 2020, if the determination as a PE for the sake of Income Tax cannot be conducted due to the implementation of an agreement with the government of another country for avoiding double taxation and preventing tax evasion, a non-tax resident subject that satisfies the provisions on significant economic presence shall be subject to the ETT. Nevertheless, for Indonesia's ETT to take effect, further implementing regulations such as Government and Minister of Finance Regulations will be required. However, Indonesia is yet to adopt these implementing regulations.<sup>11</sup>

The digitalization of the economy, on the other hand, not only causes legal issues in terms of taxation but also becomes an issue of trade between countries. In the Appellate Body Report, the World Trade Organization (WTO) appellate body made an important statement: "As long as a WTO member's tax policy is compliant with WTO regulations, the Member is free to implement any kind of tax policy."<sup>12</sup> Income tax arrangements have been removed from international trade obligations by the WTO, leaving the regulatory field to national tax laws and tax treaties."<sup>13</sup> However, with the unilateral measure set out by Indonesia, it can be considered as having created a new

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<sup>9</sup> Ichwan Sukardi and Sophia She Jiaqian, "Taxing the Digital Economy in Indonesia," *International Tax Review*, 2020, <https://www.internationaltaxreview.com/article/b1ngz37n2ts6ct/taxing-the-digital-economy-in-indonesia>.

<sup>10</sup> The determination of "significant economic presence" is based on the following factors: consolidated gross turnover of the business group, sales in Indonesia, and number of active users on digital media in Indonesia (Art. 6 Par. [7] "Regulation of The Government In Lieu of Law Number 1 of 2020" [2020]).

<sup>11</sup> Ponti Partogi and Ria Muhariastuti, "INSIGHT: Indonesia—Tax on Cross-Border Digital Services and Intangible Goods," *Bloomberg Tax*, 2020, <https://news.bloombergtax.com/daily-tax-report-international/insight-indonesia-tax-on-cross-border-digital-services-and-intangible-goods?context=article-related>.

<sup>12</sup> Appellate Body Report, "United States—Tax Treatment for 'Foreign Sales Corporations', WT/DS108/AB/R, Adopted 20 March 2000," 2000, para. 179.

<sup>13</sup> Chris Noonan and Victoria Plekhanova, "Taxation of Digital Services Under Trade Agreements," *Journal of International Economic Law* 23, no. 4 (2020): 1017, <https://doi.org/10.1093/jiel/jgaa031>.

tax policy outside the tax treaty arrangements. This condition can increase the risk of lawsuits against Indonesia based on the WTO's agreement. Therefore, the United States Trade Representative (USTR) has scrutinized Indonesian ETT based on Section 301 of the US Trade Act, and they constitute that ETT is unfair to United States companies and inconsistent with the international taxation principle.<sup>14</sup> However, the Office of the USTR terminated the Section 301 investigations of Indonesian ETT On March 26, 2021, because Indonesia had not implemented the ETT during the investigation.<sup>15</sup>

An earlier study conducted by Kofler and Sinnig discusses the general background of 'equalization taxes,' the fundamental objections raised against it, and the pertinent design features, both generally and specifically in relation to the proposal for an EU Digital Services Tax'.<sup>16</sup> There are a number of potential disadvantages and shortcomings associated with equalization taxes. Nonetheless, they are viewed by some as a politically viable solution to perceived 'unfairness' in the territorial allocation of taxing rights in a digitalized economy. While in Malaysia, there is also a study regarding DST.<sup>17</sup> The study analyzes the structure and operation of DST in Malaysia, as well as the difficulties associated with its implementation, in comparison to the European countries, which were the pioneers of DST. Furthermore, in Afrika, Magwape investigates the rationale for short-term DST measures, particularly in the context of Africa after the COVID-19 pandemic, as well as legislative measures imposed by a number of African nations. The article then contrasts the general and specific challenges (applicable to African countries) in imposing a unilateral DST with the opportunities that digital taxation presents for the continent, especially in

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<sup>14</sup> The United States Trade Representative (USTR), "Section 301 Investigations Status Update on Digital Services Tax Investigations of Brazil, the Czech Republic, the European Union, and Indonesia," 2021, 10, <https://ustr.gov/sites/default/files/files/Press/Releases/StatusUpdate301InvestigationsBEUIndCR.pdf>; Taufiq Adiyanto, "Is Indonesian Digital Tax Policy Discriminatory?," *The Jakarta Post*, 2021, <https://www.thejakartapost.com/paper/2021/02/16/is-indonesian-digital-tax-policy-discriminatory.html>.

<sup>15</sup> The United States Trade Representative (USTR), "Notice Termination of Section 301 Digital Services Tax Investigations of Brazil, the Czech Republic, the European Union, and Indonesia, Vol. 86, No. 60" (Washington DC, 2021), [https://ustr.gov/sites/default/files/enforcement/301Investigations/DST\\_Termination\\_FRN\\_March.pdf](https://ustr.gov/sites/default/files/enforcement/301Investigations/DST_Termination_FRN_March.pdf).

<sup>16</sup> Georg Kofler and Julia Sinnig, "Equalization Taxes and the EU's 'Digital Services Tax,'" *Intertax* 47, no. 2 (2019): 176, <https://doi.org/10.54648/taxi2019017>.

<sup>17</sup> Sarah Munirah Abdullah et al., "Digital Services Tax Laws in Malaysia: A Changing Landscape," *Malaysian Journal of Social Sciences and Humanities (MJSSH)* 7, no. 11 (2022): 1, <https://doi.org/10.47405/mjssh.v7i11.1925>.

devising policy and legislation and in implementing tax administrations.<sup>18</sup>

The purpose of this study is to examine and analyze the position of ETT in the framework of international trade law, particularly in WTO Law. The risk of international litigation and retaliation has made it imperative for Indonesia to ensure that Indonesian ETT is carefully imposed and cautiously designed to comply with the rules to which it has agreed under trade law. Thus, this article will identify which aspects of the architecture of Indonesian ETT greatly contribute to such risks and analyze several possible breaches of international trade law that can arise because of such tax.

## 2. Research Methods

The methodologies used in this research are doctrinal legal research. Doctrinal legal research is a research method that reviews secondary data, such as regulations and books, to bring up the truth.<sup>19</sup> The data collection technique used in this research is literature research. Secondary data used in this paper are obtained from literature research on two different sources of Law, primary sources of Law and secondary sources of Law. The primary sources of Law utilized in this research include Indonesian tax law, international tax law, and international trade law. Lastly, secondary sources of Law used in this research are mainly obtained from journal articles, working papers, and books.<sup>20</sup> The collected data are then analyzed in a qualitative manner to ensure proper processing methods are used to draw and verify the findings from this research.<sup>21</sup>

## 3. Result and Discussion

### 3.1. Indonesian Unilateral Response: ETT

Indonesia has established a legal framework for the imposition of ETT on electronic commerce conducted by foreign merchants, foreign service providers, and/or foreign

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<sup>18</sup> Mbakiso Magwape, "Unilateral Digital Services Tax in Africa; Legislative Challenges and Opportunities," *Intertax* 50, no. 5 (2022): 444, <https://doi.org/10.54648/taxi2022039>.

<sup>19</sup> Soerjono Soekanto and Sri Mamudji, *Penelitian Hukum Normatif Suatu Tinjauan Singkat* (Jakarta: Raja Grafindo Persada, 2001), 113.

<sup>20</sup> Peter Mahmud Marzuki, *Penelitian Hukum*, Edisi Revi (Jakarta: Prenada Media, 2017), 195.

<sup>21</sup> Bambang Waluyo, *Penelitian Hukum Dalam Praktek* (Jakarta: Sinar Grafika, 1991), 77.

trade through Electronic System Organizers.<sup>22</sup> Entities that deliver goods and/or services from outside the customs area with profits originating from transactions or economic activities in Indonesia shall be taxed by Indonesia. However, under the provisions of the current tax system, these profits have not been taxed. As a result, Indonesia, as a source country, is unable to enforce its taxation rights on the income derived from transactions or economic activities in Indonesia. Therefore, Indonesia faces the same challenge as other countries. Nevertheless, several countries, such as France, Italy, Austria, Spain, India, the United Kingdom, and Australia, have taken the first step by introducing or imposing unilateral taxes on electronic transactions<sup>23</sup> without waiting for an internationally agreed consensus through the OECD/G20 Inclusive Framework on BEPS.<sup>24</sup>

However, to find an alternative regulation of income tax, the Indonesian government issued a Regulation in place of Act No. 1 of 2020 at the end of March 2020. This Law regulates the tax treatment on "Trading Through Electronic Systems" (TTES).<sup>25</sup> The Law regulates tax treatment in trading activities through the electronic system in the form of the imposition of (1) Value Added Tax (VAT) on the use of intangible taxable goods and/or taxable services from outside and within the customs area through TTES and (2) the imposition of Income Tax or ETT on TTES activities carried out by foreign tax subjects who meet the provisions of significant economic presence. Simultaneously, the OECD/G-20 Inclusive Framework on BEPS kept on track to finding a solution for taxing digital transactions through global consensus. Therefore, with the existence of Act No. 2 of 2020, it can be said that Indonesia has taken steps to prepare a TTES tax with a unilateral measures approach.<sup>26</sup>

Indonesia is one of the countries that implement a combined approach between

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<sup>22</sup> Yuliana Keke Febrianti, Zainal Mutaqqin, and Amelia Cahyadini, "Strategi Pemerintah Dalam Meningkatkan Penerimaan Pajak Dari Kegiatan Perdagangan Melalui Sistem Elektronik," *Jurnal Poros Hukum Padjadjaran* 3, no. 1 (2021): 71, <https://doi.org/10.23920/jphp.v3i1.668>.

<sup>23</sup> Ernst & Young, "Digital Services Tax Jurisdiction Activity Summary," 2020, [https://assets.ey.com/content/dam/ey-sites/ey-com/en\\_gl/topics/taxation-digital-economy/ey-digital-services-tax-jurisdiction-activity-summary-as-of-1-december-2020.pdf](https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/taxation-digital-economy/ey-digital-services-tax-jurisdiction-activity-summary-as-of-1-december-2020.pdf).

<sup>24</sup> Maria R.U.D. Tambunan, "Adopting BEPS Inclusive Framework in Indonesia: Taxation Issues and Challenges in a Digital Era," *BISNIS & BIROKRASI: Jurnal Ilmu Administrasi Dan Organisasi* 27, no. 3 (2021): 141, <https://doi.org/10.20476/jbb.v27i3.11829>.

<sup>25</sup> Amelia Cahyadini et al., "Direct Tax for Digital Platform During the COVID-19 Pandemic: Study in Indonesia," *Journal of Southwest Jiaotong University* 56, no. 2 (2021): 272, <https://doi.org/10.35741/issn.0258-2724.56.2.22>.

<sup>26</sup> EY Indonesia, "Tax Policies Changes in Response to COVID-19," 2020, [https://assets.ey.com/content/dam/ey-sites/ey-com/en\\_id/topics/tax/tax-library/ey-indonesia-tax-alert-6-april\\_2020.pdf](https://assets.ey.com/content/dam/ey-sites/ey-com/en_id/topics/tax/tax-library/ey-indonesia-tax-alert-6-april_2020.pdf).

digital PE based on the Significant Economic Presence concept<sup>27</sup> and the DST approach with the imposition of Income Tax or ETT. Article 6 Para. (8) and (9) Act No. 2 of 2020 regulates in the event that the determination as a permanent establishment cannot be carried out due to the application of an agreement with the government of another country in the context of avoiding double taxation and preventing tax evasion, foreign traders, foreign service providers, and/or 'Providers of Electronic Systems used for trading activities that meet the provisions of significant economic presence, are subject to the electronic transaction tax. The electronic transaction tax is imposed on transactions on the sale of goods and/or services from outside Indonesia via 'trade through the electronic system' (TTES) to buyers or users in Indonesia carried out by foreign tax subjects, either directly or through TTES Providers.

From the two above articles, it can be concluded that ETT is imposed when a foreign taxpayer cannot be subject to Income Tax due to the application of the double taxation avoidance agreement, and ETT is imposed on the sale of goods and/or services transactions from abroad. Consequently, tax withholders and/or collection of ETT became appropriate because ETT is imposed on every transaction of selling goods and/or services from abroad, as is usually the case with deductions and/or collection of taxes other than ETT in Indonesia, which is also carried out on every transaction (transaction-based taxation). However, since the withholding and/or collection of ETT has not been regulated in existing laws and regulations, the basis for establishing the withholding and/or collection of ETT needs to be regulated, which will then become the scope of regulation of Bills.

Furthermore, in Article 6, paragraph (10) and (11) Act No. 2 of 2020 regulates Income Tax or electronic transaction tax is paid and reported by foreign traders, foreign service providers, and/or 'Providers of Electronic Systems used for trading activities' (TTES Providers). Overseas traders, foreign service providers, and/or overseas Providers of Electronic Systems used for trading activities (TTES Providers) may appoint representatives domiciled in Indonesia to collect, deposit, and report the outstanding Value Added Tax (VAT) and/or to fulfil the Income Tax obligation or electronic transaction tax.

From these two clauses that regulate the payment to fulfil these obligations, foreign traders, foreign service providers, and/or overseas TTES Providers can appoint representatives established in Indonesia to fulfil ETT obligations like ETT payments

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<sup>27</sup> José Ángel Gómez Requena, "Adapting the Concept of Permanent Establishment to the Context of Digital Commerce: From Fixity to Significant Digital Economic Presence," *Intertax* 45, no. Issue 11 (2017): 732–41, <https://doi.org/10.54648/taxi2017063>.

and reporting. The provisions on the appointment of Taxpayers and or other parties as tax cutters and/or tax collection by the Indonesian Directorate General of Taxes (DGT) are expected to be a solution not only for providing security for ETT payments but also to make it easier for the DGT to monitor the implementation of ETT tax obligations. Therefore, by using this approach, it is expected that the chance for the loss of tax revenue for the Government of Indonesia will be minimal, and it will provide an instrument of supervision for the DGT to secure tax revenues.<sup>28</sup>

In addition to the interest of state revenue, withholding and/or collecting taxes will help overcome the issue of stateless income from an international taxation standpoint. Therefore, after the enactment of the PE limitations, which were prepared by Indonesia through the issuance of Government Regulation in place of Act No. 1 of 2020, tax withholding and/or collection in principle can be an alternative or complementary policy. However, besides self-payment by foreign taxpayers who are the subject of ETT, the party that can be appointed as the most likely ETT withholder or collector is the trade operator through the electronic system in the country. This approach can be applied on the grounds of ensuring that the ETT is paid and entered into the state treasury, making it flexible for easy monitoring by the DGT. However, those provisions have not provided restrictions if foreign traders, foreign service providers, and/or foreign TTESs do not appoint Indonesia-based representatives. Therefore, if foreign traders, foreign service providers, and/or overseas TTES Providers do not appoint their representatives based in Indonesia, then there is a possibility that ETT revenue is not collected and is not reported to the DGT. If this happens, there will be a potential loss of tax revenue for the Indonesian government.

From a macro perspective, the regulation on the appointment of other parties as withholders and/or collectors of income tax is an effort by the government to ensure ideal competition for business people<sup>29</sup>, as well as between conventional and digital businesses and between domestic and foreign businesses. Thus, the appointment of other parties as income tax withholders and/or collectors provides a stimulus for fairer competition,<sup>30</sup> thereby encouraging the placement of added value and funding

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<sup>28</sup> C Alley, "Taxation of E-Commerce: Minimizing the Loss of Tax Revenue from Internet Transactions and Business," *Journal of International Taxation*, 2014, 40, <http://researcharchive.wintec.ac.nz/3524/>.

<sup>29</sup> Peer Schulze Erik van der Marel, "Taxing Digital Services – Compensating for the Loss of Competitiveness," 2020, 9, [https://ecipe.org/wp-content/uploads/2021/07/ECI\\_21\\_PolicyBrief\\_11\\_2021\\_LY04.pdf](https://ecipe.org/wp-content/uploads/2021/07/ECI_21_PolicyBrief_11_2021_LY04.pdf).

<sup>30</sup> Notika Rahmi et al., "Opportunities and Challenges Digital Tax in Indonesia," *Transparansi : Jurnal Ilmiah Ilmu Administrasi* 4, no. 2 (2021): 149, <https://doi.org/10.31334/transparansi.v4i2.1891>.



in almost all sectors that fall within the scope of the digital economy.

However, the Indonesia Government has not issued further implementing regulations regarding the ETT, such as the ETT rate and the appointment of representatives. Therefore, the Indonesian ETT follows the footsteps of other countries that apply tax on companies that do not have a physical presence but they do have a significant economic presence. Future developments will reveal the true characteristics of Indonesian ETT. However, Indonesia's ETT will also enact a certain threshold against digital companies that reflect the companies' "significant economic presence" in Indonesia, which is planned to be further regulated through the Ministry of Finance Decree.<sup>31</sup> Through the implementation of thresholds in other countries' DST measures, it can be seen that countries have set numbers that reflect a company's economic presence in a country. Malaysia has set those foreign service providers that reach the annual threshold of RM. 500,000 (about \$120,000) from consumers in Malaysia are subject to "mandatory registration", so the companies can collect DST and remit the tax to the Government of Malaysia.<sup>32</sup> Consequently, Italy has also set some thresholds against businesses that produce annual revenues from digital services exceeding €750,000,000 of international revenue and €5,500,000 in revenue arising from Italy.<sup>33</sup>

### **3.2. Indonesian ETT Under WTO Law**

This section primarily discusses Indonesian ETT from the perspective of WTO Law. The WTO system mostly excludes certain types of domestic tax from the WTO anti-discrimination rules and gives the policy space to be arranged by its members in their domestic tax laws and tax treaties. The first part elaborates on ETT, concerning Indonesia's General Agreement on Trade in Services (GATS) obligations, where it shows the potential for an ETT to violate the obligations of national treatment and Most-Favored-Nation (MFN) treatment, and the last part is the problems Indonesia will have in justifying such a tax under the available exceptions in GATS.

#### **3.2.1. General Agreement on Trade in Services**

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<sup>31</sup> Sukardi and Jiaqian, "Taxing the Digital Economy in Indonesia."

<sup>32</sup> Royal Malaysian Customs Department, "Guide On: Digital Services By Foreign Service Provider (FSP)," 2020, [https://mystods.customs.gov.my/storage/app/media/pdf/guide/Guide on Digital Service\\_V2.1\\_01022021.pdf](https://mystods.customs.gov.my/storage/app/media/pdf/guide/Guide on Digital Service_V2.1_01022021.pdf).

<sup>33</sup> EY, "Italy's Digital Services Tax Enters into Force as of 1 January 2020," 2020, [https://www.ey.com/en\\_gl/tax-alerts/ey-italys-digital-services-tax-enters-into-force-as-of-1-january-2020](https://www.ey.com/en_gl/tax-alerts/ey-italys-digital-services-tax-enters-into-force-as-of-1-january-2020).

One of the concerns raised by the ETT policy is whether it is compatible with Indonesia's non-discrimination obligations as a WTO member, especially under the GATS.<sup>34</sup> Indonesia is among the founders of the WTO and has ratified the approval of the establishment of the WTO through Act No. 7 of 1994. Therefore, if Indonesia's unilateral tax action is not carefully designed, it can violate both obligations. This section considers Indonesia's obligations in the Modes of Supplying Services of GATS, following an analysis of the GATS non-discrimination principle, especially from national treatment and MFN principles.

#### Four Modes of Supply in GATS

Based on Article I:2 of GATS, there are four scopes of service delivery modes.<sup>35</sup> Out of the four modes, only modes 1, 2, and 3 are related and can be applied in the Indonesian ETT. Mode 1 describes a non-resident service supplier operating outside Indonesia and providing services to consumers in Indonesia through a website. Mode 2 discusses consumption abroad, which is also relevant, although it can later be affected by the digital tax because online consumption via the Internet can be considered to occur outside the territory of Indonesia. Mode 3 reports that if the overseas company provides services in the form of a PE, subsidiary, or another form of commercial presence, the company supplying services in Indonesia can be subject to income tax from the supply of the services.<sup>36</sup>

In addition, ETT Indonesia is expected to affect service sales transactions from outside Indonesia via Trading Through Electronic Systems (TTES) included in the GATS schedule. The GATS schedule covers a wide scope of service sales transactions.<sup>37</sup>

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<sup>34</sup> Bakhouya Driss, "Gats and International Trade in Health Services: Impact and Regulations," *Hasanuddin Law Review* 3, no. 2 (2017): 107, <https://doi.org/10.20956/halrev.v3i2.1050>.

<sup>35</sup> Mode 1: cross-border A user in country A receives services from abroad through its telecommunications or postal infrastructure. Such supplies may include consultancy or market research reports, tele-medical advice, distance training, or architectural drawings. Mode 2: consumption abroad Nationals of A have moved abroad as tourists, students, or patients to consume the respective services. Mode 3: commercial presence The service is provided within A by a locally established affiliate, subsidiary, or representative office of a foreign-owned and -controlled company (bank, hotel group, construction company, etc.). Mode 4: movement of natural persons A foreign national provides a service within A as an independent supplier (e.g., consultant and health worker) or employee of a service supplier (e.g., consultancy firm, hospital, and construction company). See World Trade Organization, "Definition of Services Trade and Modes of Supply," [https://www.wto.org/english/tratop\\_e/serv\\_e/cbt\\_course\\_e/c1s3p1\\_e.htm](https://www.wto.org/english/tratop_e/serv_e/cbt_course_e/c1s3p1_e.htm).

<sup>36</sup> Noonan and Plekhanova, "Taxation of Digital Services Under Trade Agreements."

<sup>37</sup> Secretariat for the Council on Trade in Services, "Services Sectoral Classification List," WTO, n.d., [https://www.wto.org/english/tratop\\_e/serv\\_e/serv\\_sectors\\_e.htm](https://www.wto.org/english/tratop_e/serv_e/serv_sectors_e.htm).

However, due to the speed of digital transformation, it is conceived that commitments of the states under GATS can also bind to services that were not available at the time schedules agreed by WTO members were made. While controversial can be seen in China's case—Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products the WTO member's GATS Schedule includes services that were not necessarily technically or commercially available at the time the commitment was made.<sup>38</sup> Otherwise, technological advancement will gradually and inevitably undercut the GATS commitment.<sup>39</sup> Nevertheless, even if Indonesia does not intend to include it in its National Treatment GATT commitments, the service can still be affected. Indonesia will not be able to choose whether or not to accept a certain digital service in the schedule of commitment.

### Most Favored Nation

Under Article II:1 of GATS, a member state must immediately and unconditionally consent to the services and suppliers of services from one Member, treatment not less favourable than that accorded to providers of similar services and services from any other country. However, a member can maintain an action that is inconsistent with the requirements of Article II:1 as long as the action is registered in the MFN Exemption List of the Member concerned under Article II:2. Indonesia now arranges MFN exceptions only concerning (1) Banking Services, wherein measure relating to a joint-venture bank of national and foreign origin under which entry of a foreign bank in Indonesia is allowed on a reciprocity basis; (2) Movement of Personnel (semi-skilled workers), where Low-level occupations are reserved for Indonesian citizens. Based on Government Policy, limited exemptions can be granted to citizens of certain countries; and (3) Construction Services (government-funded projects), where measures relating to preferential shortlisting in international competitive bidding.<sup>40</sup> From these exceptions, Banking Services can be relevant to ETT in Indonesia.

The Indonesian ETT policy is de Jure a non-discriminatory measure. The requirement

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<sup>38</sup> Appellate Body Report, "China—Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products, WT/DS363/AB/R, Adopted 19 January 2010," 2010, para. 408 and 416(a), WTO.

<sup>39</sup> Tania Voon, "China and Cultural Products at the WTO.," *Legal Issues of Economic Integration* 37, no. 3 (2010): 256–57, <http://search.ebscohost.com/login.aspx?direct=true&db=buh&AN=57200686&site=ehost-live>.

<sup>40</sup> GATS, "Indonesia – Final List of Article II (MFN) Exemptions," GATS/EL/43 (15 April 1994), 1994, <https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=Q:/SCHD/GATS-EL/EL43.pdf&Open=True>.

that the MFN principles be enforced "unconditionally" does not imply that all policies of WTO members are prohibited. Different treatment to different service suppliers due to the Indonesian ETT, in principle, can be compatible with the MFN principle if it does not result in violation of competition for like services from different Members.<sup>41</sup> However, there can be "de facto" discrimination on its implementation. Indonesia's MFN obligations focus on the functionality of service providers and services from one WTO Member and suppliers of services and services from one or more other WTO Members. If the Indonesian ETT burden falls primarily on services or service suppliers from the United States, it is likely to result in less favourable treatment of the United States suppliers of services and services compared to treatment of other WTO Member service suppliers and services, thus contradicting Indonesia's MFN obligations.<sup>42</sup>

### **National Treatment**

Concerning actions affecting the provision of services, Article XVII of GATS prohibits Indonesia from treating other WTO Member service suppliers or services less favourably than it does against Indonesia's own "similar" suppliers of services and services. The National Treatment obligation only applies to the service sector listed in the Indonesia Commitment Schedule and is subject to the limitations stated in the schedule. However, it is necessary to scrutinize whether the ETT violates the obligations of Indonesia's schedule of commitment, following the National Treatment in Article XVII of GATS. From the search carried out in its Schedule, Indonesia has made various National Treatment commitments for Mode 1-3, with some limitations.<sup>43</sup> Therefore, Indonesia's Schedule of Commitment, which can be touched by the ETT, can be found in several sectors, including Telecommunications Services, Industrial Services, and tourism and travel-related services. However, in practice, the interpretation of sector/sub-sector commitments is not always certain.

Under the GATS, ETT Indonesia is considered to be discriminatory according to Article II or XVII of GATS because there is a possibility that similar services and service suppliers from one Member receive less favourable treatment than services or

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<sup>41</sup> Panel Report, "Canada—Certain Measures Affecting the Automotive Industry, WT/DS139/R, WT/DS142/R, Adopted 19 June 2000," 2000, para. 5.88.

<sup>42</sup> Andrew D. Mitchell, Tania Voon, and Jarrod Hepburn, "Taxing Tech: Risks of an Australian Digital Services Tax under International Economic Law," *Melbourne Journal of International Law* 20, no. 1 (2019), <https://doi.org/10.2139/ssrn.3347655>.

<sup>43</sup> GATS, "Indonesia – Schedule of Specific Commitments, GATS/SC/43 (15 April 1994).," 1994, <https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=Q:/SCHD/GATS-SC/SC43.pdf&Open=True>.

suppliers from another Member, which is a similar stance with the WTO Appeals Body on Argentina—Financial Services.<sup>44</sup> However, this ETT does not have the characteristics that distinguish between service suppliers based on the origin of the country. Thus, it is safe to say that there is no likeness between services or suppliers' will.

A search for the likeness element focuses on the competitive relationship between services and service suppliers.<sup>45</sup> Whether a service or service supplier is a "like" with GATS Article XVII in mind; depends on factors such as the nature of the service, its classification, end-use, and consumer preferences regarding the service.<sup>46</sup> Digital and traditional service suppliers who provide similar services are not similar.<sup>47</sup> The modes of service delivery between digital and traditional suppliers are different, and they have different business models. In addition, digital services that are provided in many sectors do not compete with other digital services. Most service sales transactions from outside Indonesia via Trading Through Electronic Systems (TTES) to buyers or users in Indonesia that are carried out by foreign tax subjects are data-driven and personalized as opposed to many conventional business practices.

Indonesia may object to the similarity analysis on the basis that the nature of the business provided is different in both physical and virtual forms. Therefore, a key consideration in assessing the similarity of digital services is the extent to which these services and service suppliers compete in practice, based on relevant evidence.<sup>48</sup> The more competition there is between digital and non-digital services in Indonesia, the more likely it is that these types of services will be considered "like."

Furthermore, regarding the scope of less favourable treatment, Indonesia's ETT does not differentiate between domestic and foreign service and service suppliers; because most of the big digital companies originating from the United States will assume that the ETT enforcement will be unjust to the United States service providers.<sup>49</sup> The future design of the ETT that is only applied to companies of a certain size, either based on

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<sup>44</sup> Appellate Body Report, "Argentina—Measures Relating to Trade in Goods and Services, WT/DS453/AB/R, Adopted 9 May 2016," 2016, para. 6.36.

<sup>45</sup> Appellate Body Report, para. 6.25.

<sup>46</sup> Appellate Body Report, para. 6.106.

<sup>47</sup> Appellate Body Report, para. 6.29.

<sup>48</sup> Mitchell, Voon, and Hepburn, "Taxing Tech: Risks of an Australian Digital Services Tax under International Economic Law," 10.

<sup>49</sup> The United States Trade Representative (USTR), "Section 301 Investigations Status Update on Digital Services Tax Investigations of Brazil, the Czech Republic, the European Union, and Indonesia," 10.

income, turnover, or assets, will eventually be discriminatory because the only company subject to tax is a foreign company. However, Indonesia's digital services companies have not achieved the same scale as foreign digital companies.<sup>50</sup> For example, if the suppliers of digital services that are taxed are mostly foreigners, while the suppliers of non-digital services that are not taxed are mostly Indonesian Entities, this difference can violate National Treatment's obligations.

Similar to the TTES on VAT that is currently being implemented by Indonesia, a greater burden is likely to be imposed on foreign services and suppliers who have already passed the ETT imposition threshold that Indonesia will set. If this threshold is high enough, the suppliers of services and services that are most likely to be taxed are foreign, for example, mainly from the United States or China. The inclusion of a threshold under which service suppliers are exempted from tax; increases the risk of breaching Indonesia's national treatment obligations, especially given the comparison here in terms of the similarity between digital service suppliers below the threshold and digital service suppliers above the threshold (not between digital and non-digital services). Indonesia could argue that service suppliers are below the chosen threshold, unlike service suppliers above the threshold.

However, drawing distinctions between similar services and service suppliers is likely to be one of the exceptions. Thereby increasing the possibility of treating other WTO Member services and suppliers of services less favourably than Indonesian suppliers of similar services, which is contrary to the obligations of National Treatment. Whereas the use of thresholds for ETTs is aimed at supporting start-ups and balancing administrative costs and compliance with state revenues,<sup>51</sup> in line with decisions of the WTO Appeals Body on alcohol and cigarette taxes.<sup>52</sup> In addition, global group income thresholds for tax rules that apply to multinational groups are used globally, including in digital producer states like the United States. However, the United States

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<sup>50</sup> The United States Trade Representative (USTR), "Section 301 Investigation, Report on France's Digital Services Tax," 2019, [https://ustr.gov/sites/default/files/Report\\_On\\_France%27s\\_Digital\\_Services\\_Tax.pdf](https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf).

<sup>51</sup> Fourth Tax Canon of Adam Smith: Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state. See Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations (Oxford's World Classic)*, ed. Kathryn Sutherland, Reprint Ed (Oxford: Oxford University Press, 2008), 826.

<sup>52</sup> Appellate Body Report, "Chile—Taxes on Alcoholic Beverages, WT/DS87/AB/R, WT/DS110/AB/R, Adopted 12 January 2000,;" 2000; Appellate Body Report, "Dominican Republic—Import and Sale of Cigarettes, WT/DS302/AB/R, Adopted 19 May 2005,;" 2005, para. 96.

has implemented a threshold of 500 million USD.<sup>53</sup> The OECD argues, based on the Impact Assessment document<sup>54</sup>, that 750 million Euros in global revenue should be the minimum threshold for Pillar One,<sup>55</sup> and recently Pillar Two used a similar threshold.<sup>56</sup>

### 3.2.2. GATS Taxation Exceptions

If Indonesia's ETT is considered to be inconsistent with its MFN and/or national treatment obligations under GATS, Indonesia can avoid violations; if it meets the general exclusion requirements in Article XIV of the GATS. Under the WTO system, the regulation with regard to tax issues has provided a special position, especially in GATS.<sup>57</sup> In Article XIV of GATS, several exceptions are provided, including Article XIV(a) GATS: Public Morals and Public Order; Article XIV (b) GATS: human, animal or plant life or health; Article XIV(c) GATS: Securing Compliance with WTO-Consistent Regulations; GATS Article XIV(d): Direct vs Indirect Taxes; and Article XIV(e) GATS: Double Taxation Agreements and Other International Arrangements. Nevertheless, there are only some of those general exceptions in GATS that presumably have a close relation to the implementation of ETT in Indonesia, namely, Article XIV paragraphs (c), (d), and (e).

Under Article XIV(c) of GATS, a state can be justified in using domestic withholding tax to secure compliance with tax laws, especially to address tax avoidance and tax evasion by the resident and non-resident tax subject.<sup>58</sup> However, for an ETT to be

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<sup>53</sup> Ernst and Young, "Final BEAT Regulations Adopt Proposed BEAT Guidance with Some Changes," Tax News Updates, 2020, <https://taxnews.ey.com/news/2020-2232-final-beat-regulations-adopt-proposed-beat-guidance-with-some-changes>.

<sup>54</sup> OECD, *Tax Challenges Arising from Digitalisation – Economic Impact Assessment* (Paris: OECD Publishing, 2020), 12.

<sup>55</sup> OECD, *Tax Challenges Arising from Digitalisation –Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project* (Paris: OECD Publishing, 2020), <https://doi.org/https://doi.org/10.1787/beba0634-en>.

<sup>56</sup> OECD, "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy," 2021, <https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf>.

<sup>57</sup> Glyn Ayres and Andrew D Mitchell, "General and Security Exceptions Under the Gatt and the Gats," *International Trade Law and WTO* 3 (2012): 4.

<sup>58</sup> Panel Report, "Argentina—Measures Relating to Trade in Goods and Services, WT/DS453/AB/R and Add. 1, Adopted 9 May 2016," paras. 7.741–7.756, 7.761.

justified under Article XIV(c) of the GATS, Indonesia needs to demonstrate that ETT's existence is necessary to ensure compliance with Indonesian laws or other regulations consistent with WTO law. Nevertheless, the emergence of ETT is triggered by the non-allocation of income tax by foreign service suppliers to market countries. Therefore, ETT excludes the exception in Article XVI (c) and the ETT is considered separate from income tax and outside the Indonesian Tax Treaties, which is, however, not necessary to ensure compliance with income tax.

Under Article XIV (d) of GATS, differences in treatment of local and foreign service providers and services can be made in the achieving of just or effective tax imposition of direct taxes in respect of services or service suppliers of other Members.<sup>59</sup> As stated, this kind of exception is only available for direct taxes measure,<sup>60</sup> while the ETT that applies to any digital service transaction, similar to Indonesian VAT, can be characterized as an indirect tax rather than a direct tax. This exception will not apply to ETTs imposed on the turnover of digital service companies. Although ETT is used as an alternative measure to impose corporate income tax because the determination of PE for the sake of income tax cannot be conducted due to the implementation of the tax treaty, ETT is an indirect tax, so it is not covered by the exception provisions.<sup>61</sup> However, if ETT is imposed on a portion of the revenue of a service supplier (e.g. the share related to the supply of digital services in Indonesia), this case would be more likely to qualify as a tax "on the income element" and can be considered to be ensuring the imposition or collection of a fair direct tax or effective in terms of exceptions in GATS.<sup>62</sup>

Under Article XIV(e) of GATS, this section provides an exception for actions that are not under the obligations of GATS. Article 2 of MFN provided that the difference in treatment is the result of a tax treaty on the avoidance of double taxation or other

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<sup>59</sup> The defence was raised in Appellate Body Report, "Argentina—Measures Relating to Trade in Goods and Services, WT/DS453/AB/R and Add. 1, Adopted 9 May 2016," paras. 7.765–7.780, 7.1073, but not considered by the panel.

<sup>60</sup> Direct taxes defined in Article XXVIII (o) of GATS as "All taxes on total income, on total capital or on elements of income or of capital, including taxes on gains from the alienation of property, taxes on estates, inheritances and gifts, and taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation."

<sup>61</sup> Vincent Beyer, "Direct Taxes and the GATS: Substantive and Procedural Defences for Non-Compliant Income Tax Measures," *Journal of World Trade* 52, no. 3 (2018): 351–73.

<sup>62</sup> Daniela Hohenwarter et al., "Qualification of the Digital Services Tax under Tax Treaties," *Intertax* 47, no. 2 (2019): 140.





arrangements by which Indonesia is bound. However, this exception is not applicable if the ETT is not covered by the existing tax treaty between Indonesia and the United States, which can trigger disputes. The ETT is a temporary measure for Indonesia while waiting for a comprehensive international solution.

#### 4. Conclusion

On May 18, 2020, in response to the outbreak of the COVID-19 pandemic, Indonesia enacted Act No. 2 of 2020 to resolve state financial stability. Act No. 2 of 2020 provides the legal justification for the imposition of income tax or ETT on electronic commerce conducted by foreign merchants, foreign service providers, and/or foreign trade that meet the requirements of having a substantial economic presence, such as Google, Amazon, and Facebook. WTO Law generally excludes certain categories of domestic tax from WTO anti-discrimination rules and allows its members to determine policy through their domestic tax legislation and tax treaties. According to Article I:2 of the GATS, there are four service delivery scopes. Only modes 1, 2, and 3 are related and applicable to the Indonesian ETT out of the four modes. Regarding Indonesia's GATS obligations, it is possible for an ETT to contravene national treatment and MFN obligations. Article XVII of the GATS prohibits Indonesia from treating other WTO Member service suppliers or services less favourably than it treats its own similar suppliers. A member state must promptly and unreservedly grant services and suppliers of services from another member the same favourable treatment accorded to providers of comparable services and services from any other country. However, the Indonesian ETT can be justified under GATS exceptions if certain legal adjustments are made to the ETT's design in accordance with Article XIV.

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