

Legal Framework and Taxation Challenges on Digital Services in Indonesia: A Normative Legal Analysis

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ABSTRACT

The rapid expansion of digital services in Indonesia has introduced significant challenges to its legal and taxation frameworks. This study employs a normative legal analysis to explore gaps and inefficiencies in Indonesia's existing regulations, with a focus on the taxation of digital services. While initiatives such as VAT on digital goods and services (PMK 48/2020) have broadened the tax base, enforcement and compliance challenges persist, particularly for non-resident providers. Comparative analysis with global frameworks, such as the OECD's Base Erosion and Profit Shifting (BEPS) initiative and the EU's Digital Services Tax (DST), highlights potential pathways for reform tailored to Indonesia's context. The study concludes with recommendations for harmonized legal frameworks, strengthened enforcement mechanisms, and policies balancing innovation with fair taxation. These reforms are essential for Indonesia to achieve a sustainable and equitable digital economy.

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1. INTRODUCTION

The proliferation of digital services has revolutionized industries and consumer behaviors worldwide, including Indonesia. With the rise of e-commerce, streaming platforms, cloud computing, and other digital business models, governments face mounting challenges in regulating and taxing these dynamic sectors. Indonesia, as one of the largest digital markets in Southeast Asia, has witnessed significant growth in its digital economy, contributing to job creation, innovation, and Gross Domestic Product

(GDP) expansion. However, this transformation presents challenges in legal governance and taxation, as the rapid development driven by fintech and e-commerce introduces complexities that existing frameworks struggle to address. The Indonesian government is thus tasked with developing effective regulatory and taxation strategies to ensure the benefits of the digital economy are maximized while minimizing risks. Taxation reforms are particularly crucial, with Indonesia's digital sector projected to contribute 4.66% to GDP by 2024 and generate millions of jobs [1]. Strategies

such as implementing digital services taxes and expanding the VAT base are being considered, although these approaches come with risks of uncertainty and potential double taxation [1]. To address these concerns, Indonesia must engage in international tax policy development and uphold principles of fairness and transparency [1]. Concurrently, the digital economy's rapid expansion has outpaced existing legal structures, creating regulatory gaps in areas like consumer protection, data privacy, and cybersecurity (Iskandar & Nugraha, 2024). Strengthening legal frameworks and enhancing enforcement capabilities are thus imperative (Iskandar & Nugraha, 2024), alongside crafting adaptive regulations to keep pace with technological and market shifts [2]. Furthermore, limitations in digital infrastructure and skills present additional barriers; inclusive infrastructure development and comprehensive digital skills training are necessary to fully harness the benefits of digital transformation [2], [3]. Addressing these infrastructural and human capital challenges can promote innovation, support financial inclusion, and drive sustainable growth within Indonesia's evolving digital economy [2], [4].

A major issue in taxing the digital economy lies in the intangible nature of digital transactions and the cross-border operations of many digital service providers, which often escape traditional taxation frameworks. Indonesia's existing tax laws—largely crafted for physical goods and services—struggle to accommodate the complex and borderless nature of digital commerce. In response, the government introduced a value-added tax (VAT) on digital goods and services through PMK 48/2020, a regulatory milestone aimed at capturing tax revenue from foreign digital platforms. However, while this step is commendable, it has revealed significant enforcement gaps and sparked debates regarding fairness, efficiency, and alignment with global tax standards. These challenges are compounded by the absence of physical presence of many digital companies in Indonesia, making it difficult to apply conventional tax rules effectively [5]. The intricate and multi-jurisdictional structure of

digital transactions further complicates data collection and tax enforcement [5]. Despite the VAT framework's attempt to respond to these issues, problems related to compliance, high collection costs, and administrative complexity persist [6]. To address these issues more holistically, the Indonesian government enacted the Tax Regulations Harmonization Law in 2022, signaling a comprehensive reform to modernize the tax system in line with digital economy demands [7]. These efforts also reflect Indonesia's intention to align its taxation approach with international developments such as the OECD's Base Erosion and Profit Shifting (BEPS) Action 1 report [6], [8]. Comparative studies indicate that Indonesia must continue refining its digital tax policies to stay competitive and ensure compliance within the global digital landscape [8].

Internationally, efforts led by the Organization for Economic Co-operation and Development (OECD) aim to address digital taxation challenges through frameworks such as the Base Erosion and Profit Shifting (BEPS) initiative and the concept of a global minimum tax, with Indonesia's active participation underscoring the urgency of aligning national tax policies with global standards to mitigate revenue losses and ensure a level playing field for both local and foreign enterprises. In this context, the present paper examines the legal and taxation challenges associated with digital services in Indonesia by employing a normative legal analysis approach to explore the limitations of existing regulatory frameworks, assess the effectiveness of recent reforms, and analyze their broader implications for the country's digital economy. By addressing these pressing issues, the study seeks to offer insights into the development of a robust legal and taxation system that not only secures government revenue but also supports innovation and competitiveness in the rapidly evolving digital sector.

2. LITERATURE REVIEW

2.1 *Legal Frameworks for Digital Services*

Indonesia's legal framework for regulating digital services, particularly

through the Electronic Information and Transactions Law (UU ITE), faces significant challenges in keeping pace with the rapidly evolving digital economy. Although the UU ITE and its amendments primarily focus on cybercrime and digital communication, they fall short in addressing broader aspects such as taxation and economic governance [9]. Recent regulatory efforts, including Government Regulation No. 80/2019 on e-commerce and the digital VAT policy under PMK 48/2020, represent important steps toward bridging these gaps (Iskandar & Nugraha, 2024), yet they do not constitute a comprehensive solution. The current legal landscape lacks coverage of emerging technologies such as artificial intelligence, blockchain, and cryptocurrency, while existing consumer protection laws are inconsistently applied and often ineffective in digital contexts [9], [10]. To address these limitations, regulatory reform must be pursued to include robust provisions on taxation, data protection, and digital sovereignty in alignment with international standards. Furthermore, enhancing legal enforcement capacity, harmonizing fragmented regulations, and promoting digital literacy and local technological innovation are crucial strategies for strengthening Indonesia's digital governance framework [10], [11].

2.2 Taxation Challenges in the Digital Economy

The taxation of digital services in Indonesia reflects global challenges in adapting traditional tax systems to the digital economy. The implementation of VAT on digital goods and services aims to broaden the tax base, but faces difficulties in identifying and ensuring compliance from non-resident providers due to the lack of physical presence [12], [13]. Legal ambiguities and weak enforcement further complicate implementation [12]. To address this, Indonesia is considering the Significant Economic Presence (SEP) model, in line with OECD guidelines, to fairly tax foreign digital companies [13],

[14]. However, SEP poses challenges, particularly with international trade agreements [15]. In the absence of global consensus, Indonesia's unilateral measures must navigate complex legal obligations while balancing economic impacts such as competitiveness and consumer behavior [15], [16].

2.3 Theoretical Perspectives

The digital economy introduces complex legal and taxation challenges that necessitate a reexamination of current frameworks through both economic and legal lenses. Economic theories of taxation, such as the benefit and ability-to-pay principles, emphasize fairness and efficiency, yet their application becomes problematic in the context of intangible digital goods and globally mobile enterprises [17], [18]. Concurrently, legal theories like digital sovereignty stress the importance of state control over digital spaces to protect national interests, but the cross-border nature of digital transactions and the absence of physical presence hinder jurisdictional claims and taxation authority [19], [20]. In response, normative legal analysis—as highlighted by Basuki (2020)—plays a vital role in systematically evaluating current legal norms and identifying necessary reforms. This approach is especially critical amid rapid technological change, which frequently outpaces regulatory adaptation. Furthermore, international cooperation efforts such as the OECD's BEPS project exemplify attempts to create standardized guidelines for digital taxation, reinforcing the importance of harmonizing domestic legal reforms with global initiatives [21].

2.4 Research Gap

While existing literature offers valuable insights into the challenges and opportunities in regulating and taxing digital services, notable gaps persist—particularly in comprehensively examining the intersection of legal frameworks and taxation policies within Indonesia's digital economy. Few studies explore how international initiatives like

the OECD's BEPS can be effectively adapted to Indonesia's specific legal, economic, and institutional contexts. This study addresses these gaps by conducting a detailed normative legal analysis of Indonesia's legal and taxation challenges in the digital services sector. By synthesizing existing insights and highlighting areas of deficiency, this review establishes a foundation for evaluating the adequacy of current frameworks and formulating actionable recommendations to strengthen regulatory and fiscal governance in Indonesia's digital economy.

3. RESEARCH METHODS

The normative legal approach systematically investigates the relationship between legal norms and their practical application in the regulation and taxation of digital services. This method emphasizes critical analysis of legal texts—such as statutes, government regulations, and international treaties—to evaluate their adequacy in addressing the distinctive challenges posed by the digital economy. This study relies on secondary data sources, including primary legal materials (e.g., the Electronic Information and Transactions Law/UU ITE, PMK 48/2020, and related tax provisions), secondary legal materials (such as academic journals, policy papers, and reports from the OECD and World Bank), and tertiary legal materials (like legal dictionaries and commentaries) to support legal interpretation and contextual understanding. The collected data is analyzed through several key steps. First, the study maps Indonesia's existing laws and identifies legal and regulatory gaps that hinder effective governance of digital services. Second, it evaluates the effectiveness of current policies, such as PMK 48/2020, by assessing their impact on VAT compliance and enforcement. Third, a comparative analysis is conducted by benchmarking Indonesia's digital taxation framework against global practices, including the EU Digital Services Tax and OECD's BEPS initiative, to extract adaptable insights. Finally, based on these findings, the study

proposes targeted legal reforms aimed at strengthening Indonesia's legal and taxation structures to better accommodate the evolving digital economy.

4. RESULTS AND DISCUSSION

4.1 Results

a. Analysis of Indonesia's Legal Framework for Digital Services

The study identified several critical gaps in Indonesia's legal framework for digital services, particularly concerning the regulation and taxation of cross-border digital transactions. One major issue is the fragmentation of existing regulations. Key laws such as the Electronic Information and Transactions Law (UU ITE) and PMK 48/2020 operate in silos and lack harmonization, resulting in legal ambiguities and inconsistent enforcement [9], [22]. As digital technologies evolve rapidly, regulatory reform is needed to ensure coherence and alignment across legal instruments to support more effective governance [9].

Another gap lies in the limited coverage of current legal provisions. Most existing laws primarily focus on consumer protection and cybercrime, offering minimal attention to the broader aspects of digital service taxation [10]. This narrow scope leaves a regulatory void in managing the growing complexities of the digital economy, particularly as digital service providers expand operations without physical presence. The absence of a comprehensive legal framework that explicitly addresses digital taxation weakens the government's ability to generate revenue and ensure fair competition [22].

Enforcement challenges further complicate Indonesia's efforts in regulating digital services. Non-resident digital service providers often evade compliance due to weak

enforcement mechanisms and jurisdictional difficulties, undermining the effectiveness of existing regulations [22]. Strengthening law enforcement capabilities and enhancing international cooperation are essential steps toward resolving these issues [9], [22]. Without strategic improvements in legal infrastructure and cross-border collaboration, Indonesia risks lagging in the global effort to regulate and tax the digital economy effectively.

b. Effectiveness of Digital Taxation Policies

The implementation of VAT on digital services under PMK 48/2020 in Indonesia has produced mixed results, reflecting both progress and ongoing challenges in adapting tax policy to the digital economy. On the positive side, the policy has effectively expanded the national tax base by targeting major international digital platforms such as Netflix, Spotify, and Amazon. These companies, previously untaxed, now contribute meaningfully to Indonesia's revenue stream, aligning with global efforts to modernize VAT frameworks for digital transactions [6]. This shift demonstrates the potential of VAT as a tool to capture value from cross-border digital activities and reduce revenue loss.

Despite these gains, persistent challenges remain—particularly in overseeing non-resident digital service providers. Limited regulatory oversight makes it difficult to ensure accurate reporting and compliance, resulting in potential revenue leakage. This challenge is not unique to Indonesia; similar problems are seen in countries like Canada, where foreign digital platforms are not subject to sales tax obligations unless they establish a business presence [23], [24]. The absence of robust monitoring mechanisms

complicates enforcement and undermines the effectiveness of the VAT regime.

Moreover, small and medium enterprises (SMEs) in the domestic digital sector face significant compliance burdens. The complexity of filing requirements under the digital VAT system poses operational challenges and adds costs, particularly for emerging businesses with limited administrative capacity. This issue mirrors trends in other jurisdictions adapting VAT systems to the digital economy, where SMEs often struggle to meet regulatory expectations [6], [25]. As such, while the VAT policy has advanced digital taxation in Indonesia, targeted reforms are needed to improve compliance frameworks and ensure equitable treatment across all digital actors.

c. Comparative Insights from Global Practices

A comparative analysis reveals that Indonesia's digital taxation policies lag behind international best practices, particularly those established by the OECD's Base Erosion and Profit Shifting (BEPS) initiative and the European Union's Digital Services Tax (DST). These global frameworks are designed to counteract profit shifting and ensure fair revenue collection from digital activities across jurisdictions. However, Indonesia's adoption of such models is constrained by regulatory limitations, institutional capacity, and socio-economic diversity, making direct implementation challenging without substantial localization. Adapting these international standards requires a nuanced understanding of Indonesia's unique digital landscape and fiscal infrastructure.

One of the main challenges in adopting the BEPS framework lies in

Indonesia's difficulty in establishing clear legal and technical guidelines, as well as improving the overall performance of its tax authority [26]. Despite some progress, the regulatory foundation and administrative capacity remain insufficient to fully embrace the OECD/G20 Pillar One framework, which aims to reallocate taxing rights over digital profits. Indonesia must also address jurisdictional complexities and modernize its tax administration systems to support such reforms effectively [27], [28]. In response, alternative strategies like a domestic Digital Services Tax or the implementation of a Significant Economic Presence (SEP) threshold are being explored to suit national capabilities.

The broader global context underscores the urgency of tax reform in response to digitalization. The OECD's BEPS initiative advocates for a broad, neutral application of new tax rules that can bridge both digital and conventional business models [29]. However, the digital economy's fast-evolving and borderless nature demands modernized tax legislation, as traditional tax provisions no longer adequately capture the value generated by digital services [30]. For Indonesia, this means moving beyond reactive policies and toward a comprehensive legal and fiscal strategy that integrates global standards while remaining responsive to domestic conditions.

4.2 Discussion

The results highlight the urgent need for an integrated and harmonized legal framework to govern digital services in Indonesia. Fragmented regulations create legal uncertainty for both businesses and tax authorities, which in turn discourages compliance and stifles innovation. To foster a supportive digital environment, Indonesia must adopt a unified regulatory approach that

comprehensively addresses taxation, consumer protection, and data governance—drawing inspiration from models such as the European Union's GDPR combined with the Digital Services Tax (DST). Establishing legal clarity and consistency will enhance investor confidence and promote equitable digital market participation.

Strengthening enforcement is equally crucial, particularly in monitoring non-resident digital service providers. Indonesia should implement advanced digital tools to track cross-border transactions and enhance tax compliance mechanisms. Additionally, international collaboration is necessary to effectively combat cross-border tax evasion and ensure jurisdictional authority over digital revenues. One viable approach is the adoption of the Significant Economic Presence (SEP) principle, which enables taxation based on economic activity within the country, even in the absence of a physical presence. Complementarily, alignment with global standards—such as the OECD's Pillar Two initiative on a global minimum tax—can help prevent profit shifting and revenue loss. Indonesia could adapt these frameworks by introducing progressive tax rates and simplifying compliance processes for both domestic and foreign digital businesses.

Striking a balance between innovation and fair taxation is essential. Overregulation or excessive tax burdens could discourage investment and digital entrepreneurship, while overly lenient policies risk enabling revenue leakage. Therefore, policies should be crafted to incentivize compliance—such as simplified tax filing systems and tax credits for startups and SMEs operating in the digital space. Based on the study's findings, the following policy recommendations are proposed: (1) Enact comprehensive legal reforms to address digital taxation, data protection, and market regulation cohesively; (2) Leverage technologies like blockchain and AI to strengthen enforcement and

monitoring; (3) Pursue international cooperation to align with global standards; and (4) Provide supportive mechanisms for SMEs by reducing administrative burdens and promoting regulatory inclusion in the digital economy.

4.3 Implications for Policy and Practice

The findings have significant implications for policymakers, tax authorities, and stakeholders in the digital economy. By adopting a more robust and harmonized approach to legal and taxation frameworks, Indonesia can enhance its revenue collection, foster innovation, and position itself as a leader in Southeast Asia's digital transformation.

5. CONCLUSION

The evolution of digital services presents both significant opportunities and complex challenges for Indonesia's economy. Although the government has introduced measures such as VAT on digital goods and services, the current legal and taxation frameworks remain insufficient to fully regulate the sector. Key problems include

fragmented and overlapping regulations, weak enforcement mechanisms, and a lack of alignment with international best practices. These deficiencies hinder not only revenue collection but also the broader goals of digital governance, such as consumer protection and data security.

This study emphasizes the urgent need for comprehensive legal reforms that integrate taxation, consumer rights, and data regulation into a cohesive framework. Strengthening enforcement through the use of advanced digital monitoring tools and international cooperation is essential for ensuring compliance, particularly from non-resident providers. At the same time, policies must strike a balance between fair taxation and the promotion of innovation and competitiveness. Drawing from global practices like the OECD's BEPS initiative and the EU's Digital Services Tax (DST), Indonesia can develop a regulatory approach that is both contextually appropriate and globally aligned. With the right reforms, Indonesia can emerge as a regional leader in digital transformation, achieving sustainable economic growth and fair taxation in the digital era.

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