

DEFINING VIRTUAL NEXUS: A COMPARATIVE STUDY OF EMERGING "DIGITAL PERMANENT ESTABLISHMENT" IN INDONESIA

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Article	Abstract
<p>Keywords:</p> <p>Base Erosion and Profit Shifting (BEPS), Digital Economy, Digital Tax, Permanent Establishment (PE), , Significant Economic Presence (SEP)</p> <p>History of Article Received: April 15, 2025; Reviewed: April 22, 2025; Accepted: April 23, 2025; Published: April 29, 2025</p> <p>DOI: 10.56282/sblr.v3i3.563</p>	<p>This normative juridical research explores the development of the Permanent Establishment (PE) concept in the context of the digital economy in Indonesia, while also comparing it to approaches adopted by various international jurisdictions and global initiatives, particularly the OECD Base Erosion and Profit Shifting (BEPS) Project. Using a comparative legal research method, this study analyzes Indonesia's traditional PE regulations as stipulated in the Income Tax Law (UU PPh) and related regulations, and evaluates the adaptation of the concept through the recognition of Significant Economic Presence (SEP). Through a comparative analysis of approaches from countries such as India, France, and international initiatives led by the OECD, the research identifies the strengths, weaknesses, and challenges associated with the implementation of a Digital PE. The findings reveal that the traditional PE concept based on physical presence is no longer sufficient to capture the tax potential of cross-border digital businesses operating without a physical presence. Consequently, the study recommends that Indonesia adopt a broader definition and criteria for PE, aligned with international standards, while also enhancing administrative capacity and enforcement mechanisms. The implications of this research include the need for international coordination and legal harmonization to avoid double taxation risks and to promote fairness in the digital taxation system</p>

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1. INTRODUCTION

The rapid advancement of digital technology has transformed traditional business models, enabling multinational enterprises (MNEs) to engage in cross-border activities without establishing a physical presence in foreign jurisdictions (Homa, 2024). This

evolution poses significant challenges to conventional principles of international taxation, particularly the concept of Permanent Establishment (PE), which traditionally relies on physical presence to determine tax liability (Schmid, 2019; Karnosh, 2021). In response, countries around the world, including Indonesia, are re-evaluating and adapting their tax frameworks to address the complexities introduced by the digital economy (Sukardi & Jiaqian, 2020). Indonesia has proactively implemented measures to tax digital transactions. In 2020, Indonesia introduced Law No. 2 of 2020, which imposes an electronic transaction tax (PTE) and value-added tax (VAT) on foreign digital service providers earning income from Indonesian consumers. This law marks a shift toward recognizing a "Digital PE," where significant economic presence, rather than physical presence, serves as the criterion for establishing tax obligations..

Globally, the OECD has taken a leading role in addressing the tax challenges arising from the digital economy. The OECD Base Erosion and Profit Shifting (BEPS) Project, particularly Action 1, focuses on developing a new nexus based on significant digital presence, aiming to ensure that profits are taxed where economic activities occur and value is created (Congressional Research Service, 2024). Various countries have adopted or are considering similar approaches, resulting in a diverse landscape of digital taxation policies (Sukardi & Jiaqian, 2020).

Meanwhile, Indonesia's Income Tax Law (UU PPh) still defines Permanent Establishment (PE) traditionally, relying on physical presence or a fixed place of business. However, in the digital era, intangible or virtual operations (e.g., online platforms, streaming services, data centers) highlight the inadequacy of the traditional PE definition under the current Income Tax Law. In contrast, some countries, such as the United Kingdom and Canada, have implemented Digital Services Taxes, while India has introduced an Equalisation Levy (Sinaga, 2024). Thus, there is a need for legal research that explores how Indonesia (and other countries) are adopting or proposing "Digital PE" frameworks to assess the legal criteria, enforcement approaches, and cross-border dispute issues.

There is a need for a legal study that seeks to comparatively analyze Indonesia's approach to Permanent Establishment (PE) against that of other countries by examining the legal frameworks, implementation challenges, and implications for international tax policy. Therefore, this study seeks to answer three primary research questions: First, what is the current legal framework governing PE in Indonesia? Second, how does the regulation of PE in Indonesia compare with that in other jurisdictions and international initiatives, such as the OECD BEPS Project, which influence national policies on Digital PE? Third, what should the future legal concept of Digital PE in Indonesia look like? This research aims to offer a novel comparative analysis of Indonesia's Digital PE framework in relation to international counterparts, focusing on legal, administrative, and policy dimensions. While existing literature discusses various national approaches to digital taxation, few comparative studies contextualize Indonesia's initiatives within the broader global landscape. By examining similarities and differences in the implementation of Digital PE, this study seeks to identify best practices, evaluate the effectiveness of various models, and propose recommendations for aligning Indonesia's digital tax policy with evolving international standards. Furthermore, this research will explore the implications of these developments for international tax treaties and the potential need for multilateral consensus to effectively address the challenges of taxing the digital economy.

2. ANALYSIS AND DISCUSSION

a) The Regulation of "Permanent Establishment" (PE) in Indonesia

The concept of Permanent Establishment (PE) in Indonesia is regulated under Law No. 36 of 2008 on Income Tax (UU PPh). This law defines PE as a business form used by non-resident individuals or entities to conduct business activities in Indonesia.¹ The criteria for establishing a PE include: having a place of business in Indonesia, the place being permanent, and the place being used by the non-resident to carry out business activities.² Forms of business that can constitute a PE include various physical and operational locations such as branch offices, representative offices, factories, workshops, warehouses, and even electronic agents or automated equipment used to conduct business via the internet.³

Recognizing the limitations of the traditional PE concept in the digital era, Indonesia has taken steps to adapt its tax regulations. One such effort is the issuance of Minister of Finance Regulation (PMK) No. 35/PMK.03/2019 on the Determination of Permanent Establishment.⁴ This regulation provides guidance for determining the existence of a PE, including definitions related to places of business, construction projects, service activities, dependent agents, and insurance agents. PMK-35 emphasizes that a place of business must have a permanent location and be used by a foreign taxpayer to conduct business activities in Indonesia. However, PMK-35 does not explicitly address cross-border digital transactions or the Digital PE concept. Nevertheless, this regulation has expanded the PE definition to include digital activities. Under PMK-35, a PE can be constituted through computers, electronic agents, or automated equipment owned, leased, or used by a non-resident to conduct business via the internet. This expansion acknowledges that digital businesses can establish a significant economic presence in Indonesia without a physical footprint.

Prior to the enactment of the Harmonization of Tax Regulations Law (UU HPP), Indonesia had introduced the concept of Significant Economic Presence (SEP) through Law No. 2 of 2020 as part of its efforts to advance the digital taxation framework. This law stipulated that foreign digital companies with a significant economic presence in Indonesia could be deemed to have a Permanent Establishment (PE), even without a physical presence, if certain criteria were met. These criteria included thresholds based on the group's consolidated gross turnover, revenue generated from Indonesian consumers, or the number of active users in Indonesia. If a double taxation avoidance agreement (P3B) prevented the formation of a PE based on these criteria, then an Electronic Transaction Tax (PET) could be imposed on the digital company's transactions in Indonesia.⁵

In cases where a foreign entity is deemed to have a PE in Indonesia, it is required to: obtain a Taxpayer Identification Number (NPWP) within one month of commencing business activities, file periodic and annual tax returns (SPT), and register for Value Added Tax (VAT) if delivering taxable goods or services (JKP) in

¹ Nusantara, (2020). Permanent Establishment in Indonesia. Available at <https://nusantaralegal.com/artikel/permanent-establishment-in-indonesia.html>, accessed on April 13, 2025.

² Wibowo Mukti, (2025). A New Rule to Determine Permanent Establishment. Available at <https://www.ahp.id/client-update-10-april-2019/>, accessed on April 15, 2025.

³ Nusantara, *Ibid*.

⁴ Endang Mahpudin, (2024). Digital tax reform in Indonesia: Perspective on tax policy development. *Journal of Infrastructure, Policy and Development*, 8(8).

⁵ *Loc.cit*.

Indonesia.⁶ Non-compliance with these obligations may result in administrative sanctions, and in some cases, blocking of market access in Indonesia by the Ministry of Communication and Informatics.⁷

b) Comparative Study of PE Regulations in Selected Jurisdictions and International Initiatives

In various jurisdictions and international initiatives, approaches toward Digital PE vary. Several countries have introduced the concept of "significant economic presence" to establish tax obligations for digital companies without requiring physical presence. For example, India has implemented the Significant Economic Presence (SEP) concept, allowing the establishment of a PE based on digital transactions exceeding certain thresholds, even without physical presence. India has proactively adapted its tax laws to address the challenges posed by digitalization. The Finance Act of 2018 introduced the SEP concept, expanding the definition of business connections to include digital transactions that surpass specified revenue or user thresholds. This enables India to tax non-resident digital companies based on their economic presence, regardless of physical location. In addition, India implemented the Equalization Levy, initially at 6% and later extended to a 2% levy on e-commerce operators, targeting revenue generated from digital services provided to Indian residents.⁸ These measures reflect India's commitment to effectively taxing digital activities.⁹

The European Union (EU) has also considered similar approaches through proposals such as the Digital Services Tax (DST) to impose taxes on revenue earned from digital services, notably through France. France has taken significant steps toward taxing digital activities. The French Administrative Supreme Court, in the case of *Conversant International Ltd*, broadened the definition of PE to include digital marketing services provided by a foreign company through its French subsidiary.¹⁰ The court ruled that the subsidiary's activities created a PE for the foreign company, even without physical presence. Furthermore, France introduced a 3% DST on revenue from certain digital services, primarily targeting large multinational companies. This initiative reflects France's efforts to ensure that digital businesses contribute fairly to its tax base.

Various countries employ different criteria to establish tax nexus for digital businesses without requiring physical presence. Common criteria include Significant Economic Presence (SEP), user participation, and Digital Services Tax (DST). SEP establishes a PE based on the volume of digital transactions or revenue generated from a particular jurisdiction. User participation links tax liability to the level of interaction or participation of users within the jurisdiction. DST is imposed through a direct tax on revenues earned from specific digital services, such as online

⁶ Nusantara, *Ibid*.

⁷ PWC, *Ibid*.

⁸ Mukesh Patel *et al.*, (2023). India has significantly expanded its equalization levy: The expanded equalization levy covers a majority of e-commerce services. Available at <https://itif.org/publications/2025/02/11/india-digital-tax-policy>, accessed on April 15, 2025.

⁹ ITIF (2025). India's Digital Tax Policy. Available at <https://itif.org/publications/2025/02/11/india-digital-tax-policy>, accessed on April 15, 2025.

¹⁰ WTS Global (2022). France: Continuation and end of the *Conversant International Ltd* case - Permanent establishment in the digital field. Available at https://wts.com/global/publishing-article/2022018-france-permanent-establishment-in-the-digital-field~publishing-article?utm_source=chatgpt.com, accessed on April 2, 2025.

advertising or user data sales. These three approaches reflect global efforts to adapt tax systems to digital business models that no longer rely on physical presence.

One of the key international initiatives related to the Digital PE concept is the OECD Base Erosion and Profit Shifting (BEPS) Project, along with the United Nations (UN) Model Tax Convention, which defines a Permanent Establishment (PE) as a fixed place of business through which the business of an enterprise is wholly or partly carried on. This traditional definition emphasizes physical presence, which is increasingly inadequate in the digital economy.

The BEPS Project has influenced national policies through its two main pillars, alongside the OECD Model Tax Convention: Pillar One proposes the reallocation of certain taxing rights to market jurisdictions, allowing countries where users are located to tax a portion of the profits of digital companies, even in the absence of physical presence.¹¹ Pillar Two introduces a global minimum tax to prevent multinational enterprises from shifting profits to low-tax jurisdictions.¹² These initiatives encourage countries to adjust their domestic tax policies to align with international standards and reduce tax avoidance practices. Additionally, the UN Model Tax Convention introduces the concept of a "Service PE," allowing the source country to tax income from services provided within its territory, even without a fixed place of business.

The OECD BEPS Project, OECD Model Tax Convention, and the UN Model Tax Convention fundamentally aim to prevent the artificial avoidance of PE status by redefining the PE concept to encompass digital activities. This includes addressing strategies such as commissionaire arrangements and fragmentation of business activities designed to avoid tax obligations. The Multilateral Instrument (MLI) facilitates the implementation of these changes across various tax treaties, promoting a more consistent and comprehensive approach to taxing digital businesses globally.

This comparative analysis highlights the evolving approaches to defining and taxing PEs in the digital economy. Countries such as India and France have expanded their domestic tax laws to cover digital activities, while Indonesia has introduced measures to tax foreign digital companies based on economic presence. International initiatives, such as the OECD BEPS Project, aim to harmonize these efforts and provide a cohesive framework for taxing digital businesses. Understanding these developments is crucial for policymakers and multinational enterprises navigating the complexities of international taxation in the digital era.

c) The Ideal Legal Concept of Digital PE in Indonesia

The evolution of the Permanent Establishment (PE) concept in Indonesia must emphasize a shift away from the traditional physical presence requirement toward embracing comprehensive digital economic activities. The conventional PE concept, which relies on physical presence, is becoming increasingly inadequate in addressing the taxation of digital businesses operating without a tangible footprint. The analysis should highlight Indonesia's proactive approach in adapting its tax regulations to the digital economy, ensuring that foreign digital businesses contribute fairly to national revenue. Indonesia's current PE framework, as outlined in the Income Tax Law (UU

¹¹ OECD, Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, 2020, available at https://www.oecd.org/en/publications/tax-challenges-arising-from-digitalisation-report-on-pillar-one-blueprint_beba0634-en.html, accessed on January 2, 2025.

¹² *Loc.cit.*

PPh), which emphasizes physical presence through a fixed place of business or dependent agent, needs to shift toward recognizing Significant Economic Presence (SEP) as a basis for taxation, moving beyond the traditional PE concept. A crucial consideration is that digital companies can generate substantial income from Indonesian consumers without any physical presence, leading to challenges in tax collection and potential revenue loss.¹³

To effectively tax digital businesses, Indonesia's legal framework should incorporate the following elements:

- 1) Economic Nexus Criteria
Establish clear thresholds based on revenue, user base, or digital interaction that constitute a taxable presence.
- 2) Inclusion of Digital Activities
Recognize digital platforms, online services, and other non-physical business models as potential PEs when they have substantial economic engagement with the Indonesian market
- 3) Alignment with International Standards
Ensure consistency with global initiatives, such as the OECD BEPS Project, to facilitate cooperation and minimize double taxation risks.
- 4) Robust Enforcement Mechanisms
Develop strong administrative tools and technological capabilities to effectively monitor, assess, and collect taxes from digital entities.

In implementing an expanded PE concept, Indonesia indeed faces several challenges, including issues related to legal harmonization, technological infrastructure, and administrative capacity. The challenge of legal harmonization pertains to aligning domestic law with international tax treaties to avoid conflicts and ensure legal clarity. The challenge of technological infrastructure involves enhancing digital monitoring systems to track and assess the activities of foreign digital companies. The challenge of administrative capacity concerns the effort to build expertise and resources within the tax authority to manage the complexities of digital taxation.

The analysis of the shortcomings of Indonesia's traditional PE concept in the digital context, along with the proposed legal framework, is part of the broader effort to develop a presence-based criterion rooted in economic nexus. By aligning with international standards and improving administrative capabilities, Indonesia can establish a fair and effective tax system for the digital economy.

Several benefits are associated with implementing a Digital PE framework in Indonesia: First, an increase in tax revenue. It allows the country to tax digital companies that were previously untaxable under traditional PE rules, thereby boosting tax collections. Second, tax fairness. It creates a level playing field between digital companies and traditional businesses that maintain a physical presence. However, several challenges accompany the implementation of a Digital PE framework, including: a) Complexity of Implementation. Establishing and implementing new criteria requires complex legislative and administrative reforms. b) International Resistance. Some countries, especially those that host major tech

¹³ M. Rizqi, Naufal Rizqiyanto, Fahmil Alfian, dan Badreddine Berrahlia, (2025). Regulation Challenges in the Digital Economy Era: Legal Analysis and Implications in Indonesia. *Trunojoyo Law Review*, 7(1), 65-102. DOI: 10.21107/tlr.v7i1.28540.

companies, may oppose these changes, considering them discriminatory or inconsistent with international tax agreements.¹⁴ c) Risk of Double Taxation. Without adequate international coordination, companies could face the risk of being taxed multiple times on the same income across different jurisdictions.

To enhance the effectiveness of Digital PE regulations in Indonesia, several best practices can be considered:

- a) Adjustment of Domestic Regulations
Adopt definitions and criteria for PE that incorporate the Significant Economic Presence (SEP) concept, aligned with the evolving nature of digital business models.
- b) Participation in International Forums
Actively engage in international discussions and negotiations, such as those led by the OECD, to ensure that national interests are represented in global standards.
- c) Strengthening Tax Administration Capacity
Enhance the capabilities of the tax authorities in detecting and monitoring cross-border digital business activities, including leveraging information technology and data analytics.
- d) International Cooperation
Establish cooperation with other jurisdictions through information exchange and tax compliance enforcement mechanisms to prevent tax avoidance by multinational digital enterprises.

By implementing these practices, Indonesia can more effectively tax digital business activities and ensure a fair and efficient tax system.

3. CONCLUSION

The advancement of digital technology has rendered the traditional Permanent Establishment (PE) concept, which relied on physical presence, increasingly inadequate in the digital economy. Indonesia has taken significant steps by introducing the concept of Significant Economic Presence through domestic regulations such as Law No. 2 of 2020 and PMK-35 of 2019, although the traditional PE definition still predominates under the Income Tax Law (UU PPh). Comparative studies show that jurisdictions like India and France have more extensively adopted approaches that expand the PE definition to tax digital activities, through mechanisms such as Significant Economic Presence (SEP) and the Digital Services Tax (DST). The OECD BEPS Project, particularly Pillar One and Pillar Two, has also driven significant global reforms. Indonesia must align its Digital PE concept with international standards, strengthen enforcement mechanisms, and address the challenges of legal harmonization and tax administration capacity. The effective implementation of a Digital PE framework is expected to increase tax revenues, ensure tax fairness, and mitigate the risks of double taxation.

¹⁴ Anne Gordon, Letter: A history of discriminatory targeting of US companies, available at https://www.ft.com/content/d3cc0cad-c13a-4dd6-99b2-9131d1ad73ae?utm_source=chatgpt.com, accessed on February 2, 2025.

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