

Pillar One and Two - A Solution on Digital Economy (Indonesia Perspective)

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Introduction

As we all know, in a pretty surprising statement on 8 October 2021, more than 130 jurisdictions under the OECD/G20 Inclusive Framework on Base Erosion And Profit Shifting ("BEPS") has publicly agreed on two pillars solutions to address the tax challenges from the digitalization of the economy. Well, of course, there are questions about how big and how far the impact of the two-pillars Solutions to Indonesia's economy. Nevertheless, it is fascinating to anticipate one of the most remarkable developments in international taxation, which, among others, would establish a new platform of taxation to deal with the digital economy issue that has been under the spotlight for quite some time.

Background and Development

As a member of the G20 and an active member of the Inclusive Framework, Indonesia has also heavily participated in the process for years, since the release of BEPS action 1 in 2015. Indonesia's participation, of course, is not done without purpose. Indonesia has taken the digital economy issue very seriously, which could be proven by the policy choice that has been taken. In the state of the pandemic of COVID-19, one of the first responses to overcome the challenges and pressures of the economic downturn by the Government of Indonesia is the enactment of a law 2/2020 through which a new permanent establishment definition is extended to cover "significant economic presence" concept. Such an extension is aimed, especially, to tax digital-economy-generated income of foreign companies whose residences are in Indonesia's non-treaty partners.

Furthermore, Indonesia also prepares another policy to anticipate situations where existing tax treaties, as would happen in most cases, effectively disallow the permanent establishment definition change to tax the digital economy income. In such a case, a new type of tax (a digital tax) would be imposed on those companies. Although once subjected by the USTR investigation, that new tax is a straightforward way to overcome the digital economy issue without directly infringing the formal sanctity of tax treaties. However, as several times stated by its public officials, including the Minister of Finance, Indonesia continually reaffirm its commitment to support the global consensus on the digital

economy rather than executing the policies abovementioned unless there is no choice other than to do so.

From public records, it could be seen that Indonesia's government has never stepped back from its commitment to a global consensus. The latest development, of course, is the expansion of international tax agreement provision in the income tax act via the enactment of Law 7/2021 as part of holistic Indonesia's tax reform, which provides a legal platform to implement Pillar One and Pillar Two. Hence, as far as publicly known, the acceptance and development of Pillar One and Pillar Two in Indonesia are as fast as possible, especially after the drastic u-turn taken by none other than the US. While US President Trump's administration dragged their feet on the efforts, which delayed the process, President Joe Biden's administration seems to take a different strategy. Now, not only the US is supporting the global consensus, but it also seems that it takes the role of a broker thereto. When the US is on board, the long-awaited agreement, as seen from the 8 October's statement, is just around the corner.

The question right now is: what is next? Following the 8 October's statement, G20 finance ministers in their communiqué plan to sign the multilateral convention in mid-2022, followed by global enforcement in 2023. A very ambitious timeline considering how challenging the Multilateral Instrument on BEPS's implementation, a previous international taxation breakthrough. Also, there are still many things to do.

As we understood, Pillar One introduces the unprecedented and globally coordinated platform of taxation to make taxation by, most importantly, market jurisdictions with limited physical presence to obtain a fair share of profits made by companies who have been enjoying the comfort of non-taxation while operating digitally in global level. On the other hand, Pillar Two focuses on addressing the remaining BEPS issues, mainly by introducing the global minimum tax to end the race-to-the-bottom by the so-called tax haven, hub, or other intermediaries jurisdictions.

While the underlying ideas in those two pillars are noble, still, the devil is in the details. From the 8 October statement, we could understand that Pillar One, through its element, Amount A, would only cover multinational enterprises (MNEs) with global turnover above 20 billion euros and profitability above 10%. Further, tax mustered under Amount A would be allocated only to a market jurisdiction when qualified MNE derives at least 1 million euros in revenue from that jurisdiction or 250,000 euros for jurisdictions

with GDP lower than 40 billion euros. Lastly, the income that is the object of Amount A taxation is the residual profit defined as profit in excess of 10% of revenue.

Even though Amount A will generate billions of taxes as OECD claims, from the details of the scheme, it seems that the economic impact of Pillar One would be kept at the minimum level. Moreover, the implementation of Amount A would require the removal of unilateral measures on digital taxation worldwide, which is very consistent with the goal of the USTR, which had launched many investigations toward digital taxes all over the world. Hence, it is vital for Indonesia's government to accurately, carefully, and wholly calculate the ups and downs of the global consensus, especially when the calculation leads to minimum additional tax from Amount A and greater potential income tax foregone as a consequence thereof.

Conclusion

Lastly, regardless of many homework that is still needed to be done by Indonesia's government regarding Pillar One and Pillar Two, it is understandable that sometimes compromise is needed for the greater good. Consistent with Indonesia's foreign policy, it is one of the goals of this great country to facilitate modern world peace, e.g. by avoiding a global trade war, which could potentially happen if triggered by unilateral measures by countries. Thus, if the compromise means little additional tax from Amount A, factually is better than nothing under the traditional international tax norms and treaties. However, we should fully support Indonesia's government, especially the Ministry of Finance, to ensure that the sacrifice is not worse than that.