

## A PERSPECTIVE ON IMPOSING IMPORT DUTY ON DIGITAL GOODS IN INDONESIA

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### ABSTRACT:

*Since 1998, the WTO Members have applied a moratorium against tariffs on international electronic transmissions (commonly referred to as the WTO 'E-Commerce' Moratorium). However, some WTO Members have recently taken steps to undermine the Moratorium, given the potential revenues that might be generated by imposing tariffs on electronic transmissions, included Indonesia. With this potential revenues generated by imposing tariffs on electronic transmissions, the Indonesian government issued Ministry of Finance Regulation No. 17/PMK.010/2018, provides Chapter 99 to covers intangible goods (ie, software and other digital products) that previously were not covered under the Indonesian tariff system. The next issues after regulation issued are how governments develop new capabilities to implement it. This study will explore alternative policy to implement customs regulation related to digital goods with a qualitative approach using the case study.*

**Keywords:** *Digital Goods, E-commerce, Indonesian Customs*

## 1. INTRODUCTION

Global Web Index reports that Indonesia has the highest rate of ecommerce use of any country in the world, with 90 percent of the country's internet users between the ages of 16 and 64 reporting that they already buy products and services online (datareportal.com, 2019). Statista reports that Indonesians spent US\$20.3 billion online in 2018, an increase of US\$3.3 billion – or 20 percent – compared to 2017. Within that overall figure, US\$9.5 billion went to online purchases of consumer goods like fashion, electronics, and groceries, while US\$9.4 billion went to online travel purchases. The remaining US\$1.4 billion went on digital media purchases (Statista Digital Market Outlook, E-commerce Industry, 2019). Although the digital economy has rapidly grown in Indonesia during the past several years, but its contribution to tax revenue is still insignificant. Ministry of Finance, Sri Mulyani Indrawati, said that the current revenues does not yet reflect the potential use of the internet, e-commerce, and the population of Indonesia (cnnindonesia.com, 2019). This condition is related to WTO policy.

Since 1998, the WTO Members have applied a moratorium against tariffs on international electronic transmissions (ET) (commonly referred to as the WTO 'E-Commerce' Moratorium). The moratorium is due to lapse on 31 December 2019—unless a decision is taken at a WTO General Council meeting in December to extend the moratorium until the 12th WTO Ministerial Conference in Nur-Sultan, Kazakhstan in June 2020. However, some WTO Members have recently taken steps to undermine the Moratorium, given the potential revenues that might be generated by imposing tariffs on electronic transmissions (WTO, 2019).

The results of the simulation exercise which brings down the bound tariffs of ET products to zero show that: if permanent moratorium is applied to the customs duties which have been periodically brought down to zero on the ET-Products, then there will be a further rise in imports of ET-Products by the developing countries while imports of the developed countries will remain unaffected, as their duties are already zero (Rashmi Bangga, 2017).

Article 8b paragraph 2 Customs Law No. 17 of 2006 stated that "Delivery of electronic software and / or data for import or export can be done through electronic transmission." It means that Indonesia actually has anticipated digital economy since years ago. With this potential revenues generated by imposing tariffs on electronic transmissions and as follow up of Article 8b paragraph 2 Customs Law No. 17 of 2006, the Indonesian government issued Ministry of Finance Regulation No. 17/PMK.010/2018 (regulation 17) on the Second Amendment of Regulation No. 6/PMK.010/2017 on Stipulation of Goods Classification System and Import Duty on Imported Goods on 15 February 2018. This study will explore alternative policy to implement regulation with a qualitative approach using the case study method.

## 2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### 2.1 Digital Goods

Digital tax laws are evolving all the time, almost as fast as technology is innovating. Countries introduce new tax rules to capitalize on this booming economy. Definitions of a

“digital goods” ,“digital product”, “electronic transmissions”, “over the top services” or other terms change from region to region, or state to state.

There is no universally recognized definition of digital products. The most commonly cited definition comes from two publications by the Streamlined Sales Tax Governing Board (SSTGB) in US, a multistate effort to simplify sales and use tax collection and administration. According to the Streamline Sales and Use Tax Agreement (SSUTA) and the SSTGB’s rules and procedures, “specified digital products” include digital audiovisual works, digital audio works, and digital books (Joyce Beebe, 2019):

- a. **Digital audiovisual works** are series of related images that, when shown in succession with accompanying sounds, impart an impression of motion. This category includes movies, music videos, news shows, entertainment programs, and recorded live events. The SSTGB documents specify that video greeting cards and video games are not included.
- b. **Digital audio works** are the products resulting from the recording of musical, spoken, or other kinds of sounds. These include songs, music, audiobooks, speeches, ringtones, and other sound recordings. Audio greeting cards sent by e-mail are not part of this category.
- c. **Digital books** are works that are generally recognized in the usual sense as “books.” This category includes novel-length works of fiction and nonfiction, as well as short stories. However, it does not include chat rooms, blogs, periodicals, magazines, newspapers, or other news or information products.

With different term, according to Moktar Mnakri (2015), “Over-The-Top refers to applications and services, which are accessible over the internet and ride on Operators’ networks offering internet access services e.g. social networks, search engines, amateur video aggregation sites, etc.” The definitions can be quite detailed and various, such as:

- Audio, visual, or audio-visual products, for example; E-books, images, movies, and videos, whether buying a copy off of Amazon or using a service like Netflix, Sound Cloud or Spotify.
- Online courses /e-Learning materials.
- Cloud-based software and as-a-Service products, such as Software-as-a-Service (SaaS), Platform-as-a-Service (PaaS), and Infrastructure-as-a-Service (IaaS). (Although these products can have their own specific SaaS tax rules.)
- Websites, site hosting services, and internet service providers.

## 2.2 Customs Regulation on Digital Goods

The Indonesian government issued Ministry of Finance Regulation No. 17/PMK.010/2018 (regulation 17) on the Second Amendment of Regulation No. 6/PMK.010/2017 on Stipulation of Goods Classification System and Import Duty on Imported Goods on 15 February 2018. Regulation 17 provides Harmonized Systems Code Chapter 99 to covers intangible goods (ie, software and other digital products) that previously were not covered under the Indonesian tariff system.

As shown in the table 1, Notes of Chapter 99 Software and other Digital Goods:

1. Software and other digital goods transmitted electronically referred to in heading 99.01 are those that are not related to machines or devices that have been or will be imported.
2. Software and other goods transmitted electronically related to machines or devices.

Subheading Notes of Chapter 99 Software and other Digital Goods explained that tariff line 9901.40.00 covers only software that is a renewal or update of said software for machine or devices that have already been imported.

Tabel 1 Chapter 99 Software and other Digital Goods

No.	Pos Tarif/HS Code	Uraian Barang	Description of Goods	Bea Masuk/ Import Duty
(1)	(2)	(3)	(4)	(5)
	<b>99.01</b>	<b>Peranti lunak dan barang digital lainnya yang ditransmisikan secara elektronik</b>	<b>Software and other digital product transmitted electronically</b>	
10287	9901.10.00	- Piranti lunak sistem operasi	- Operating system software	0%
10828	9901.20.00	- Piranti lunak aplikasi	- Application software	0%
10829	9901.30.00	- Multimedia (audio, video atau audio visual)	- Multimedia (audio, video or audio visual)	0%
10830	9901.40.00	- Data pendukung atau penggerak sistem permesinan	- Supporting or driver data, including design for machinery system	0%
10831	9901.90.00	- Piranti lunak dan barang digital lainnya	- Other software and digital product	0%

Source: Ministry of Finance Regulation No. 17/PMK.010/2018

In the Ottawa Taxation Framework, there is a principle of neutrality when tax treatment must be neutral and equal between conventional and electronic form of commerce. If the digital industry is not taxed, while the traditional industry (mortar and brick) is taxed, then it is a different treatment (uneven playing field) (OECD, 2003). The government believes imposing the import duties and taxes will “create a level playing field between online and offline sellers and increase fiscal revenues” (kontan.co.id, 2018).

### 2.3 Problem Identification

The borderless nature of digital economy produces specific administrative issues around identification of businesses, determination of the extent of activities, information collection

and verification, and identification of customers. Operational work is underway with respect to these administrative issues within the Forum on Tax Administration (OECD, 2014):

- a. **Identification:** While global business structures in the digital economy involve traditional identification challenges, these challenges are magnified in the digital economy. For example, the market jurisdiction may not require registration or other identification when overseas businesses sell remotely to customers in the jurisdiction, or may have issues with implementing registration requirements, as it is often difficult for tax authorities to know that activities are taking place, to identify remote sellers and to ensure compliance with domestic rules. Difficulties in identifying remote sellers may also make ultimate collection of tax difficult.
- b. **Dermining the extent of activities:** Even if the identity and role of the parties involved can be determined, it may be impossible to ascertain the extent of sales or other activities without information from the offshore seller, as there may be no sales or other accounting records held in the local jurisdiction or otherwise accessible by the local revenue authority. It may be possible to obtain this information from third parties such as the customers or payment intermediaries, but this may be dependent on privacy or financial regulation laws.

Tabel 2 Areas of Debate on How Best to Tax and Regulate Digital business

Debate	Action (or proposal)	Potential Risk
Firms not charge corporate tax where they operate remotely	Revised nexus and profit, allocation rules	Some losers in reallocation of taxing rights; increased complexity
Profit-shifting to tax havens	Global minimum tax	Constraints on small countries reliant on low tax rates; increased complexity
Loss consumption taxes (VAT/GST) via e-commerce	New collection models for low-value imported goods	Collection costs for online marketplaces
Duty-free digital goods and services import	Customs duties on electronic transmissions	Hindered growth and innovation; unworkable implementation
Privacy and enforcement risks from unrestricted data flows	Data localization measures; conditional transfer	Increased business costs
Competition concerns around digital platforms	Enhanced enforcement; revised merger review; separate digital market authority	Conflicting decisions; US political backflash

Source: World Economic Forum, 2019

- c. **Information cc. Collection and verification:** To verify local activity, the market jurisdiction's tax administration may need to seek information from parties that have no operations in the jurisdiction and are not subject to regulation therein. While exchange of information can be a very useful tool where the proper legal basis is in place, this is predicated on knowledge of where the offshore entity is tax resident and information retained or accessible by the reciprocating tax authority. This can create challenges for a market jurisdiction revenue authority seeking to independently verify any information provided by the offshore entity.
- d. **Identification of customers:** There are in principle a number of ways in which a business can identify the country of residence of its client and/or the country in which consumption occurs. These could include freight forwarders or other customs documentation or tracking of Internet Protocol (IP) and card billing addresses.

However, this could be burdensome for the business and would not work where customers are able to disguise their location.

As shown in the table 2, there are six live areas of debate on how best to tax and regulate digital business to optimize economic and societal outcomes (World Economic Forum, 2019). One of the potential risk from debate issue about customs duties on electronic transmissions is “unworkable implementation”, which is relevant with regulation 17 that issued by government. This study will explore how Indonesian Customs develops new capabilities to implement it.

### **3. RESEARCH METHODS**

The research method is qualitative descriptive. The analysis covers the situation and the impacts that occur and how the next main plan issues with the scope of the discussion on import activities. Primary data from interviews with Indonesian Customs officials, while secondary data was obtained from Indonesian Customs.

Instead interviewing, this research use research method by using case study that is a digital business company. This method provides an opportunity to see more sides of digital business, so there will be many strategies that can be used to make policy on taxing digital goods. This data collection uses three methods, namely interview, observation and literature study.

#### **3.1 Interview**

The data used were collected through in-depth interviews on customs officer the technical directorate of customs and the information directorate of customs and excise. "Interviews have the power in their ability to target and focus directly on topic case studies as well as in their insights in delivering perceived causation and explanation conclusions (Yin, 2009)". Meanwhile, according to Thomas "They give a 'rich picture' of this business, seen in it interpretive light, and in fact the person interviewed will determine the direction of the Interview (Thomas, 2011)." Questions used in different interviews, based on who the interviewee. "Interviews can be done in a structured and unstructured and can be done with face to face or use the phone (Sugiyono, 2010)".

#### **3.2 Observation**

"Some forms of observation that can be used in qualitative research, i.e. participant observation, unstructured observation and unstructured group observation (Bungin 2007)". In this research using unstructured observation method, that is observation done without observation guide. Researchers directly observe the business that is running. The oversight is done directly on the ongoing business.

#### **3.3 Literature Study**

Literature study, this is the method used to collect all information or data from responsible sources, such as books or journals, after completion of the data collection process, the results of the interview will be analyzed. The results of the analysis will then be adjusted to the review literature.

#### 4. ANALYSIS AND DISCUSSION

This study discuss four specific administrative issues of digital goods based on OECD (2014), those are around identification of businesses, determination of the extent of activities, information collection and verification, and identification of customers.

##### 4.1 Identification (Subject)

For customs authorities, the biggest challenge in the world of customs right now is the treatment of intangible goods. There is an issue who is required to make declaration, the customer who downloads the product or the local selling party to the customer. Based on current digital goods concept of Indonesian Customs, The Subject who should declare is the one who downloads the the product, regarded as importer. For the early implementation step, it will be limited to legal entity (corporate) as subject and this entity is excluded from the customs registration. This concept is relative easy to be implemented, but for the next step, Indonesian Customs should be imposing import duty and tax to broader party, such as individual person and foreign/remote seller.

However, the challenge for this scheme is how to apply to providers who are not yet incorporated in Indonesia, given that taxation provisions only regulate permanent establishment provisions, only obliging providers that are physically present in Indonesia.

Tabel 3 Indonesian Customs Concept on Digital Goods

DGCE Concept on Digital Goods	
<b>Why</b>	<ul style="list-style-type: none"> <li>to record trade balance on digital goods, type of digital goods</li> <li>security aspects (IPR infringement, transnational organized crime, 3D printing, money laundering)</li> <li>to create a level a level playing field between domestic digital goods which has been being a tax object and import digital goods</li> </ul>
<b>Who</b>	The subject is legal entity(corporate) Excluded from the customs registration
<b>What</b>	The object is digital goods (HS Code 99.01) which have been set up in PMK 17/PMK.010/2018
<b>How</b>	The current import duty is 0%
<b>Much</b>	PPN: 10% PPH: 2.5%
<b>How</b>	<ul style="list-style-type: none"> <li>Notified using digital declaration or periodically submitted Digital Declaration (simplified document)</li> <li>Excluded from the submission of transportation documents</li> <li>No prohibition and restriction provision</li> <li>Submitted to designated Customs Office</li> <li>Audit supervision</li> </ul>

Source: Digital Goods (Indonesian Customs, presentation), 2018

Meanwhile, most providers are physically located overseas.

The Minister of Finance said that the government would charge providers who were economically present, as was the case in Australia, the US and some developed countries, which required tax registration. The government will change the definition of Permanent Establishment from initially based on the presence of a company's physical office in Indonesia (physical presence) to be based on economic activity in Indonesia (economic presence) (kontan.co.id, 2019). The author agree with that statement and propose that Indonesia government should do benchmarking its policy with other country.

#### **4.2 Determining the Extent of Activities (Object)**

It appears to us, currently intangible goods can be interpreted broadly and open ended, to include any types of applications, software, video, audio, e-book etc. The object is digital goods (HS Code 99.01) which have been set up in PMK 17/2018 and there is no prohibition and restriction provision on this digital goods. From an import duty calculation perspective, there may not be any changes at this time as the import duty tariff for intangible goods is still 0%. However, the fact that there is already a 0% rate, it could be changed depend on the intention of the government to push this matter through eg, to increase the state revenue.

Thus, this also means that there is always a possibility that the government increases the duty rate anytime in the future. Based on study of willingness to pay import duty for digital goods showed that the mean of import duty rates on digital goods ready to be paid was 6.40% (Maharseto, 2018). To create a level playing field between online and offline sellers and increase fiscal revenues, this study propose to raise import duty rate from 0% to 6.4% or more.

#### **4.3 Information Collection and Verification**

Based on the results of interviews with one of the sections in the information directorate of customs and excise, a personal opinion was conveyed that the readiness of the government's information technology infrastructure is currently possible through a simple oversight mechanism through voluntary declarations. This scheme can be similar on royalty's case or scheme of electricity, gas, or liquid importation case.

Indonesian Customs For the next step, can implement Partnership Scheme and Redirect Mechanism. In Partnership scheme, Indonesian Customs may cooperate with celular provider (direct carrier billing), payment consolidator (bank and credit card provider), and exchange information with overseas platform.

In addition to the administration of customs and excise tax collection carried out by customs institutions, there are other options, namely based on the results of an interview with one of the Section Heads in the information directorate of customs and excise, it is proposed that administrative activities of import duty collection and PDRI be entrusted to the Directorate General of Taxes. It is against this background that import activities are carried out outside the customs area in terms of physical location and the company in terms of taxation are required to do routine reporting (period), so that for efficiency and effectiveness can be combined as well as related reporting.

#### **4.4 Identification of Customers**

Another element to be considered is how to value the importation of these digital or intangible goods as there are no database to rely on. This may have an impact for least two years after the submission of the import declaration as under current Indonesian Customs Law, the customs authority can re-assess the customs value in a customs audit exercise within two years after import declaration. To measure customer compliance, Indonesian Customs needs to do an audit supervision. They could examine invoice and contract

document, trade agreement, taxation document, or other customs documentation or tracking of Internet Protocol (IP) and card billing addresses.

#### 4.5 Case Study: Netflix

Netflix is a pioneer in online movie rental services. Netflix was established since 1997, Netflix accommodates the most complete movie archives with the most operating areas. Netflix is a streaming service that offers a wide variety of award-winning TV shows, movies, anime, documentaries, and more on thousands of internet-connected devices (netflix.com, 2019). As internet speeds get faster, services similar to Netflix begin to appear. An example is Google Play Movies, the service specifically targets Android and Chrome users. Google Play Movies uses a pay-per-view mechanism or pays every time you watch a movie. While Netflix is an on-demand service or pay subscriptions on a monthly basis without limitation on the movies watched.

Quoting Statista (2019) this year the number of subscribers in Indonesia reached 481,450. Next year is expected to rise to 906,800. First basic services are IDR 109,000 per month, then Standard services are IDR 139,000 per month and Premium are IDR 169,000 per month (netflix.com, 2019).

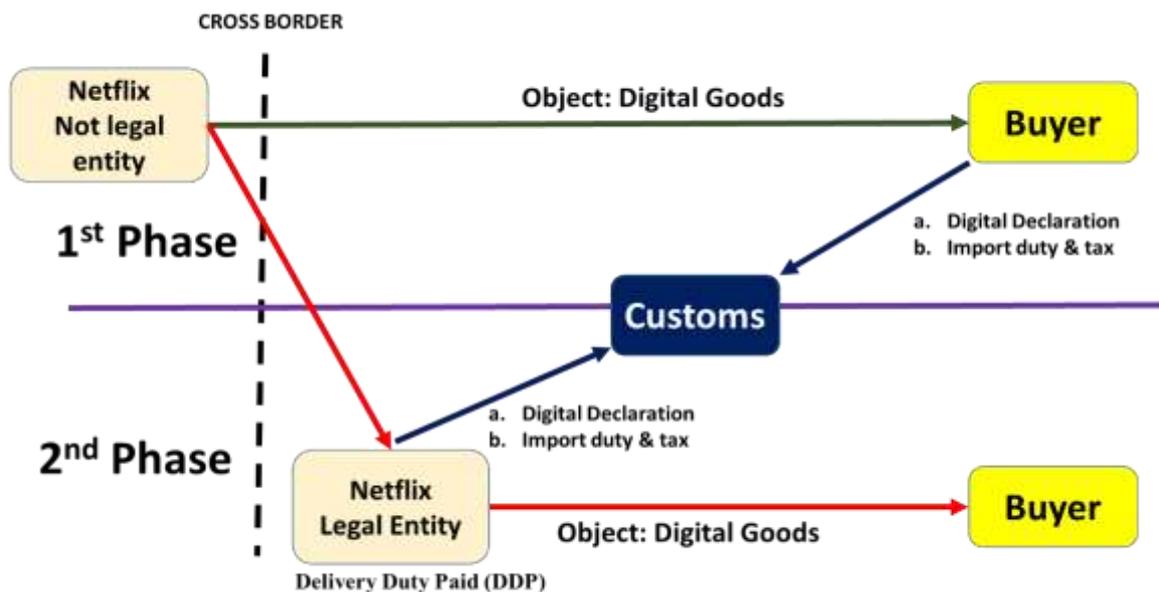


Figure 1 Proposed Concept on Digital Goods: Study Case Netflix

Source: The Author, 2019

If 481,450 subscribers in Indonesia mean Netflix gets IDR 52.4 billion per month. That is also the calculation of the cheapest package that must be paid by subscriber IDR 109,000. So in a year Netflix can pocket IDR 629 billion. All poured into Netflix accounts in the Netherlands. Seeing Netflix's own obligations, if using VAT at 10% then Netflix must deposit to a country of IDR 62 billion. Not to mention income tax or others. Australia, the European Union, Japan, and Korea have implemented and quoted taxes from Netflix. There is even a rule called Netflix Tax (businessstimes.com.sg, 2018). Unfortunately, the problem of companies from abroad or over the top service for Indonesia still has problems with tax

regulations Because of current regulations, we have not been able to force them to become permanent establishment (domestic tax subjects).

Based on those condition above, this study proposed the policy to be implemented gradually into two phase as shown in the figure 1:

a. The First Phase:

- Importation of digital goods through electronic transmission will be declared by Netflix customer (self-declaration and self-assessment using digital customs declaration (online). However, for the first phase, the application is still limited to legal entity (corporate).
- Netflix is required to announce this regulation information to all customers.
- Importer can access digital declaration form through customs website and will receive a billing statement that needs to be paid.
- Indonesian Customs will check all the payment at the time of periodic audit, thus there is no clearance check.
- Netflix is required to share the database to Indonesian Customs.
- There is no requirement to declare free of charge transactions such as updated and renewal, so long as no payment related to the renewal (no payment, no taxes).
- Importer is excluded from customs registration, transport documents submission, prohibition and restriction provision.
- Required documents to declare are Invoice and Contract document, trade agreement, or other similar documents.

Tabel 4 Recommendation for Digital Business Administration Issue

No.	Administration Issue	Current	DGCE concept	Rekomendasi
1.	Identification (subject)	n/a	1. The Subject is legal entity (corporate) 2. Excluded from the customs registration	Overseas remote sellers are required to register as Permanent Establishment
2.	Determining the extent of activities (object)	Digital goods (HS Code 99.01) which have been set up in PMK 17/2018, with Import Duty rate: 0%	a. Digital goods (HS Code 99.01) which have been set up in PMK 17/2018, with Import Duty rate: 0% b. No prohibition and restriction provision	a. To obtain this information from third parties such as the customers or payment intermediaries may be dependent on privacy or financial regulation laws. b. Import duty rate: 6,4% c. Delivery duty paid concept
3.	Information collection and verification	n/a	1. Notified using digital declaration or periodically submitted digital declaration (simplified document) 2. Submitted to designated Customs Office 3. Excluded from the submission of transportation documents	1. Simple scheme: Self-declaration, Direct carrier billing scheme, Payment gateway scheme, exchange of information with other partner countries 2. Complex supervision mechanisms
4.	Identification of customers	n/a	Audit supervision	These could include invoice and contract document, trade agreement, taxation document, or other customs documentation or tracking of Internet Protocol (IP) and card billing addresses.

Source: The Author, 2019.

b. The Second Phase:

- Obligations of traders and service providers who sell through the marketplace platform to notify the tax registration number to the marketplace platform providers and carry out the income tax obligations in accordance with applicable laws and regulations.
- Marketplace platform providers are required to: have a tax registration number and be confirmed as a taxable enterprise; collect, deposit, and report value added tax and income tax related to the sale of merchandise belonging to the marketplace platform providers themselves; Report a recapitulation of transactions made by platform user traders.
- Application of Delivery Duty Paid (DDP) Schemes, where marketplace platform providers are required to calculate import duties and / or tax and are responsible for depositing import duties and / or taxes for goods at the beginning of the transaction.

## **5. CONCLUSION**

### **5.1 Conclusion**

- a. The Indonesian government issued Ministry of Finance Regulation No. 17/PMK.010/2018 (regulation 17) on the Second Amendment of Regulation No. 6/PMK.010/2017 on Stipulation of Goods Classification System and Import Duty on Imported Goods on 15 February 2018. Regulation 17 provides Harmonized Systems Code Chapter 99 to covers intangible goods (ie, software and other digital products) that previously were not covered under the Indonesian tariff system.
- b. Although regulation has been issued, cross border e-commerce tax regulations, included intangible goods and service, have not been implemented, so that the state loses potential revenue.
- c. Indonesian Customs has provided trade and industry facilities and online service and payment applications, but infrastructure networks including the internet must be improved.
- d. The provision has not yet reached business entity who run digital businesses in Indonesia but have been carried out electronically from abroad and have not been Indonesian legal entities.

### **5.2 Recommendation**

- a. The government should reserve policy space in the WTO for shaping digital industrialization policies – abstaining from any negotiations on e-commerce as “new issues” as well as not agreeing to permanent moratorium on customs duties on digital product since future digital products are unknown
- b. The government must change the definition of Permanent Establishment from initially based on the presence of a company's physical office in Indonesia (physical presence) to be based on economic activity in Indonesia (economic presence)
- c. The government must issue operational rule how to implement regulation 17.

- d. The government should improve infrastructure networks, applications and the internet to be reliable.
- e. The government should be better reviewing import duty rate on digital goods that create a fair level playing field for local digital economic industry.
- f. The government may consider the author recommendation as shown on table 4.

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