Reconstructing the Concept of Permanent Establishment in the Global Era of Significant Economic Presence

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This research examines the reconstruction of Indonesia's Permanent Establishment (PE) concept in response to the challenges of the digital economy. The rise of digital platforms and cross-border data transactions has diminished the relevance of the traditional PE definition, which relies on physical presence as the basis for taxation. Through a normative juridical approach, the study analyzes the inadequacy of existing regulations and explores the adoption of the Significant Economic Presence (SEP) principle as a new tax nexus. The analysis demonstrates that SEP offers a fair and modern legal mechanism to capture value creation derived from digital engagement, ensuring fiscal equity and protecting national tax sovereignty. Its effective implementation requires harmonisation between domestic law, international tax treaties, and administrative reform. The study concludes that integrating SEP into Indonesia's taxation framework represents a necessary evolution toward a more just, adaptive, and comprehensive system suited for the digital era.

Keywords: Permanent Establishment; Significant Economic Presence; Digital Economy

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1. Introduction

The rapid evolution of the global economy toward digital-based activities has profoundly transformed paradigms in both international and domestic tax law, particularly regarding the concept of Permanent Establishment (PE). Traditionally, the existence of a PE within Indonesia's tax system has been determined by physical presence, meaning that a foreign enterprise must have a fixed place of business in Indonesia for its income to be subject to taxation by the state. This principle is embedded in Indonesia's legal framework, especially in Law Number 36 of 2008 on Income Tax and its implementing regulations. However, as the digital economy enables enterprises to generate substantial income from a country without any physical or tangible presence, this traditional approach has become increasingly inadequate in addressing the realities of cross-border digital activities.[1]

This inadequacy is evident in the dominance of global technology corporations such as Google, Meta, Amazon, and Apple, which conduct extensive economic activities within Indonesia through online platforms, digital advertising, and data-driven transactions without establishing a physical business presence. These activities produce significant economic value within Indonesia's digital market but often escape domestic taxation due to the physical nexus requirement under the existing legal definition of a Permanent Establishment. Consequently, the state loses a considerable portion of potential tax revenue from cross-border digital transactions. This situation underscores the urgent need to reconstruct the concept of Permanent Establishment in order to incorporate the notion of Significant Economic Presence (SEP) as a new legal mechanism for determining taxable presence based on substantial economic engagement rather than physical form.[2]

At the international level, the Organisation for Economic Co-operation and Development (OECD) has pioneered efforts to expand the traditional tax nexus through the Base Erosion and Profit Shifting (BEPS) Project, particularly Action Plan 1: Addressing the Tax Challenges of the Digital Economy. The OECD recognises that the conventional PE concept no longer aligns with the characteristics of modern digital business models. The SEP concept was thus introduced as a way to ensure fair taxation among jurisdictions by defining “significant economic presence” in digital terms. This includes indicators such as the number of active users, transaction volumes, and the overall economic value created within a jurisdiction. The approach shifts the basis of taxation from physical to digital and economic reality, reflecting a substantive rather than a formalistic understanding of presence.

In Indonesia, the application of SEP principles has gained attention following the enactment of Law Number 2 of 2020 on State Financial Policy and Financial System Stability, which provides the legal foundation for taxing transactions conducted through electronic systems. The Directorate General of Taxes has subsequently issued several implementing regulations, including Minister of Finance Regulation Number 48/PMK.03/2020 concerning the Procedures for the Appointment, Collection, and Remittance of Value Added Tax on Electronic Commerce Transactions. Although this regulation primarily concerns administrative mechanisms, it marks a paradigm shift toward recognizing economic presence as a valid basis for taxation. Hence, a comprehensive reconstruction of the PE concept is essential to encompass foreign entities deriving substantial economic benefits from Indonesia’s digital market, even in the absence of a physical establishment.[3]

Reconstructing the PE concept through SEP involves not only technical aspects of taxation but also broader philosophical and juridical dimensions. From an international tax law perspective, the principles of tax fairness and legal certainty must underlie any state effort to define cross-border taxing rights. The reconstruction must acknowledge that the economic substance of a transaction, rather than its physical or formal manifestation, forms a legitimate basis for taxation. Thus, digital corporations generating significant economic value within Indonesia should be legally recognized as having a virtual permanent establishment based on the intensity of their economic activities. This approach reflects an adaptation of the legal framework to the realities of the digital economy while maintaining alignment with international tax principles.

From a juridical standpoint, implementing SEP within Indonesia’s domestic legal system requires harmonisation with international tax treaties. The main challenge lies in reconciling national regulations with the provisions of double taxation avoidance agreements (DTAAs), which mostly retain the traditional definition of a PE as a “fixed place of business.” To effectively implement SEP, Indonesia needs to consider amending or renegotiating relevant treaties to ensure consistency between domestic and international law [4]. Without such harmonisation, the legal enforcement of SEP-based taxation risks uncertainty and potential disputes in international fora. Therefore, any legal reform must be systematically integrated into Indonesia’s broader framework of international tax cooperation.

Furthermore, reconstructing the PE concept demands robust legal mechanisms for enforcement in the digital domain. Establishing and proving significant economic presence in cyberspace requires legal instruments capable of accurately tracing digital transactions and economic activities. This entails inter-agency coordination between the tax authority, communications regulator, and law enforcement institutions with expertise in data analytics and digital forensics. Strengthening Indonesia’s legal capacity in data governance and cross-border information exchange is thus indispensable to ensure the effective and fair administration of tax law in the digital age.

From an economic perspective, the implementation of SEP and the redefinition of PE carry strategic significance for Indonesia's fiscal sovereignty. As tax revenue remains the backbone of national development financing, the ability to capture income derived from digital business models will substantially augment the country's tax base. Moreover, such reforms promote equal treatment between domestic taxpayers and foreign digital enterprises, fostering a more equitable competitive environment. Reforming the PE concept is therefore not only a legal necessity but also an economic imperative aimed at safeguarding fiscal justice and ensuring distributive fairness in the global digital economy.[5]

The urgency of reconstructing Indonesia's PE concept can be examined through three fundamental dimensions. First, the normative legal dimension, which demands that the legal framework evolve to accommodate the realities of digital commerce. Second, the administrative dimension, concerning effective enforcement and compliance mechanisms for digital transactions. Third, the philosophical dimension, emphasizing justice and equality in taxation across different types of business presence. These interrelated dimensions constitute the foundation for a reformed tax law system that is both fair and responsive to global technological developments.

Given these global dynamics and domestic challenges, Indonesia stands at a critical juncture in redefining its Permanent Establishment concept. The integration of Significant Economic Presence into national tax law represents not only a technical adaptation but also a reaffirmation of fiscal sovereignty in the digital era. By adopting SEP as a guiding legal principle, Indonesia can ensure equitable taxation of digital economic activities, strengthen the legitimacy of its tax policy framework, and secure a fair share of global economic value generated within its jurisdiction.

2. Literature Reviewe

A substantial body of literature has identified the limitations of conventional taxation principles in addressing the complexities of the digital economy. In particular, the traditional concept of Permanent Establishment (PE) which relies on physical presence is widely regarded as insufficient for capturing the economic substance of cross-border digital activities [6]. Under Article 5 of the OECD Model Tax Convention, a PE traditionally requires a fixed place of business or a physical facility. However, as Devereux and Vella (2018) argue, this physical nexus fails to account for digital business models such as e-commerce platforms, online services, and cloud computing that can generate substantial economic value without any tangible presence in a market jurisdiction.

In response to this gap, academic discourse has advanced the concept of Significant Economic Presence (SEP) as a modern nexus standard. Hellerstein (2019) defines SEP as a criterion that emphasises digital interaction, user participation, and the creation of economic value within market jurisdictions. This approach aligns with the value-creation framework developed under the OECD/G20 Base Erosion and Profit Shifting (BEPS) Action 1. Empirically, Olbert and Spengel (2017) demonstrate that SEP enables source countries to tax digital enterprises based on the scale and intensity of their digital economic engagement such as the number of users, volume of data generated, or user-generated content rather than on physical location alone.

The literature generally agrees that shifting from a physical PE to an SEP nexus is essential for protecting the fiscal sovereignty of market states and achieving fairness in global taxation. Furthermore, legal reconstruction that integrates SEP offers a coherent path toward aligning domestic regulations with the realities of digital commerce and contemporary economic activities [7].

Problem Statement

The rapid expansion of the digital economy challenges Indonesia's ability to effectively impose taxation on foreign enterprises that generate substantial economic value without physical presence. The traditional definition of Permanent Establishment, based on the "fixed place of business" criterion, fails to capture the realities of digital trade and cross-border data-driven transactions. This inadequacy results in lost tax revenue and legal uncertainty in enforcing fiscal obligations. Therefore, the core problem lies in reconstructing the Permanent Establishment concept to incorporate the principle of Significant Economic Presence as a fair and effective basis for taxation in Indonesia's digital era.

3. Method

This research employs a normative juridical approach, which focuses on analyzing legal norms, principles, and doctrines governing taxation and international economic law. The study examines primary legal materials including Indonesian tax legislation, government regulations, and relevant international instruments such as tax treaties and OECD guidelines [8]. Secondary materials comprise academic publications, expert commentaries, and official policy documents related to the implementation of the Significant Economic Presence concept. The analysis is conducted through qualitative interpretation based on a statutory, conceptual, and comparative framework to assess the alignment between Indonesia's legal framework and global practices. The research aims to identify normative gaps, examine the consistency of domestic regulations with international standards, and formulate recommendations for reconstructing the Permanent Establishment concept within Indonesia's tax law. Through this method, the study achieves systematic and critical evaluation of applicable legal provisions in responding to the challenges of the digital economy.

4. Results and Discussion

Limitations of the Traditional Permanent Establishment Concept

The traditional concept of Permanent Establishment (PE), rooted in the idea of physical presence, has historically served as the legal foundation for determining a country's right to tax foreign enterprises conducting business within its territory. The PE concept emerged from early twentieth-century international tax practice, at a time when economic activity was intrinsically linked to physical assets, production sites, and tangible operations. Its legal definition, widely reflected in Article 5 of the OECD Model Tax Convention, centers on the notion of a "fixed place of business through which the business of an enterprise is wholly or partly carried on." This approach assumes that income-generating activity is inseparable from a company's physical footprint in a jurisdiction. However, in today's digitized and globally integrated economy, such assumptions no longer reflect actual business realities. The proliferation of digital technology, the rise of platform-based commerce, and the increasing value of intangible assets have fundamentally disrupted the traditional nexus between physical presence and economic activity [9].

In the modern digital economy, technological advancement allows multinational enterprises to provide goods, services, and digital content to consumers across jurisdictions instantaneously and without traditional infrastructure. A company can generate enormous economic value from a market through data collection, targeted advertising, and digital transactions all conducted remotely via the internet. For example, global technology companies operating in Indonesia may earn substantial revenue through online advertisements, cloud storage subscriptions, or digital services without establishing a local office, server, or workforce. Under the traditional PE framework, these companies are not subject to corporate income tax because they lack physical presence. Consequently, a significant portion of the value created within

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Indonesia's borders remains untaxed, eroding the state's fiscal sovereignty and undermining the principle of fairness in taxation.

The structural weakness of the traditional PE lies in its failure to account for digital value creation and the dematerialized nature of modern business operations [10]. The economy has undergone a profound transformation from tangible goods-based production to intangible, knowledge-driven models. The key drivers of corporate profit data, user participation, algorithms, and digital networks are not confined to any specific geographic territory. They exist across borders, migrate through digital channels, and depend on global market access. Thus, when a multinational enterprise utilizes Indonesian consumer data to generate advertising revenue or monetizes user engagement within Indonesia, it engages in economic activity that effectively constitutes "participation in the life of the market." Yet, under the current PE definition, such activity does not establish a taxable presence. The legal framework thereby fails to reflect the economic substance of value creation in the digital age [11].

This misalignment between law and economic reality leads to substantial fiscal consequences. Developing countries such as Indonesia, which serve as large digital markets, face systematic revenue losses as profits are shifted to low-tax jurisdictions where multinational digital corporations are formally incorporated. These outcomes contradict the core objectives of international taxation namely, ensuring that income is taxed where economic activities occur and where value is created. The traditional PE principle, by excluding digital participation as a criterion for taxable presence, inadvertently enables base erosion and profit shifting. The result is a fiscal imbalance between market jurisdictions, where users and consumers generate value, and residence jurisdictions, where multinational corporations declare their profits. This imbalance weakens tax equity and exacerbates socio-economic disparities, as domestic enterprises remain fully taxed while foreign digital operators contribute minimally to public revenue. [12]

From a legal perspective, the traditional PE concept also raises issues of interpretative rigidity and enforcement uncertainty. Its dependence on the "fixed place of business" test limits tax authorities' capacity to address complex digital operations that are virtually structured and geographically dispersed. In practice, identifying whether a server, website, or digital platform constitutes a PE under existing legal definitions is highly contested. Jurisdictions differ in interpreting whether the mere presence of a website or local domain creates a sufficient nexus for taxation. The OECD Commentary offers guidance but stops short of recognizing digital presence without physical infrastructure. Consequently, domestic tax authorities face significant evidentiary challenges when seeking to prove that a foreign enterprise has established taxable activity within their territories. Without a clear legal pathway to assess virtual business models, such enforcement remains limited and subject to dispute.[13]

Furthermore, the evolution of digital trade has blurred traditional distinctions between goods, services, and intangible assets. Under the PE framework, business activities are typically categorized for tax purposes according to their physical form and operational structure. Yet in the digital environment, these distinctions become obsolete. A single online transaction may involve the simultaneous exchange of data, intellectual property, and digital service provisions all delivered electronically. The traditional tax rules fail to adequately classify these hybrid activities, leading to interpretative fragmentation and legal uncertainty. This problem is especially pronounced in Indonesia, where domestic tax legislation and bilateral treaties still rely heavily on the conventional PE definition. The mismatch between formal legal criteria and actual economic functions creates a gap between taxation policy objectives and legal implementation.[14]

Another dimension of the problem concerns the principle of neutrality in taxation. A sound tax system must ensure that similar economic activities are taxed in similar ways, regardless of business model or technological medium. However, the current PE-based framework inherently discriminates between brick-

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and-mortar enterprises and digital operators. While domestic businesses operating within Indonesia are fully subject to corporate income tax, foreign enterprises that engage digitally with Indonesian consumers often fall outside the tax net simply because of the absence of physical infrastructure. This divergence creates an uneven competitive environment, disadvantaging local firms and undermining economic fairness. Over time, such asymmetry discourages domestic digital innovation and erodes public trust in the equity of the tax system.

Beyond these economic and administrative implications, the persistence of the traditional PE model also raises broader legal and philosophical questions about the authority of the state to tax in a globalized, virtualized economy. The classic territorial concept of jurisdiction where sovereignty over taxation corresponds to geographic control becomes increasingly outdated in an environment where economic activities transcend borders without any physical crossing. The state must therefore redefine the legal meaning of “presence” and “connection” in taxation [15]. The traditional model assumes that physical occupation of territory constitutes the most direct and legitimate link between enterprise and state. However, digitalization demonstrates that value creation and market engagement occur through virtual interaction, online communication, and user participation all of which produce genuine economic effects within a jurisdiction. Legal recognition of such non-physical forms of presence is essential to preserve fiscal autonomy in the digital age.

Additionally, the conventional PE framework is inadequately equipped to handle the proliferation of digital intermediaries and platform-based ecosystems. In many digital markets, value is generated not by direct sales but through indirect interactions between users, advertisers, and content providers. For instance, social media platforms monetize user attention, data, and algorithmic insights activities that yield substantial economic benefit without any physical channel of exchange [16]. Yet under current tax law, these virtual engagements remain untaxed because they do not meet the “fixed place” requirement. This structural limitation reveals a deeper normative issue: the law’s excessive reliance on form over substance. By focusing on tangible business forms rather than the substantive economic relationships underlying digital activity, the PE concept undermines the principle that taxation should reflect actual economic participation.

The inadequacy of the traditional PE also manifests in the imbalance between administrative feasibility and technological capability. Tax authorities today possess sophisticated digital tools to trace cross-border transactions, monitor financial data, and identify digital profit streams. Nevertheless, legal frameworks rooted in outdated definitional boundaries restrict their ability to apply these resources effectively. In Indonesia, for example, digital service providers can maintain large customer bases and generate millions in annual revenue without registering a physical entity or fulfilling corporate tax obligations. This situation demonstrates not an absence of information, but an absence of legally recognized nexus. The discrepancies between technological progress and legal definition thus create administrative inefficiency and weaken enforcement credibility [17].

Moreover, the global nature of digital business poses challenges of coordination among jurisdictions. The traditional PE model presupposes clear delineation of taxing rights between residence and source countries based on physical location. Yet digital enterprises often operate through distributed networks where data servers, intellectual property assets, and consumer markets are dispersed across multiple states. This fragmentation complicates attribution of profits and increases the risk of double non-taxation. The lack of an updated international consensus further exacerbates legal uncertainty. While some countries have introduced unilateral measures such as digital service taxes or expanded PE definitions, these actions often conflict with existing tax treaties, leading to the potential for overlapping taxation and cross-border

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disputes. Indonesia's experience reflects this global tension: its domestic initiatives to tax digital platforms must coexist with treaty obligations that remain anchored in traditional PE terminology.

From a policy standpoint, retaining the traditional PE doctrine hinders Indonesia's ability to pursue fiscal modernization and equitable taxation. The digital transformation of the global economy has rendered traditional tax bases increasingly fragile, as value creation migrates from physical assets to intangible resources. If the PE concept remains unchanged, the tax base will continue to erode, diminishing state revenue and limiting public investment capacity. Furthermore, reliance on outdated legal terminology may deter foreign cooperation and reduce the credibility of Indonesia's tax policies in international forums. A modern, inclusive, and technology-responsive legal framework is therefore imperative to restore coherence between domestic and international taxation systems [18].

In assessing the implications of these limitations, it becomes evident that the traditional PE framework not only fails to capture digital economic realities but also undermines key legal principles such as equality, neutrality, and legal certainty. Equality is compromised when similar income streams are taxed differently based solely on operational form. Neutrality is violated when tax burdens distort market competition between digital and non-digital enterprises. Legal certainty is weakened as ambiguous definitions fuel interpretative disputes and enforcement challenges. From the perspective of legal theory, these deficiencies point to a fundamental misalignment between normative design and empirical reality an imbalance that can only be resolved through doctrinal reform.

For Indonesia, the persistence of these challenges signals an urgent need for legislative reconstruction that redefines the scope of taxable presence. While this reconstruction may begin with technical amendments to national tax law, it must be grounded in a broader conceptual shift: recognizing that economic participation, rather than physical occupation, constitutes the legitimate basis for taxation in the digital economy. The introduction of criteria such as the volume of digital transactions, number of users, or level of market engagement could serve as proxies for determining a significant economic nexus. Such transformation would bring Indonesia's tax law closer in alignment with international reform trends and strengthen the state's capacity to assert its fiscal sovereignty in an increasingly virtual global marketplace.

Ultimately, the limitations of the traditional Permanent Establishment concept encapsulate a broader tension between static legal norms and dynamic economic structures. As business activities continue to evolve beyond geographic boundaries, legal systems must respond by redefining the foundations of jurisdictional authority in taxation. The shift from a purely territorial to an economically substantive interpretation of presence represents not merely a technical adjustment, but a reaffirmation of the law's capacity to adapt to changing realities while upholding justice, efficiency, and national sovereignty. The digital economy demands that tax law recognize the intangible yet tangible influence of virtual business operations, ensuring that every enterprise contributing to a nation's economic ecosystem bears an equitable share of its fiscal responsibilities. Only through such reconstruction can Indonesia safeguard both legal integrity and fiscal sustainability in the era of digital globalization.

The Adoption of Significant Economic Presence as a New Tax Nexus

The emergence of the Significant Economic Presence (SEP) concept signifies one of the most transformative developments in the evolution of international taxation. It seeks to redefine the legal understanding of "taxable presence" in response to the digitalization of economic activity, which has rendered traditional notions of nexus based strictly on physical presence obsolete. In essence, SEP introduces a conceptual departure from territoriality toward a more functional and market-oriented approach. The principle asserts that a business enterprise, regardless of physical establishment, may be deemed to have a taxable presence within a jurisdiction if it maintains sustained and significant economic interaction with that market's

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consumers or digital users. This reconceptualization aims to restore the balance between source and residence countries, ensuring that the jurisdiction where value is effectively created often through user participation and market engagement retains the right to tax the income generated there [19].

For Indonesia, the adoption of SEP presents both an opportunity and a challenge. As one of the largest digital markets in Southeast Asia, Indonesia hosts millions of online users whose data and consumption contribute substantial value to global technology corporations. However, because these enterprises operate without tangible infrastructure within the country, the existing tax framework fails to capture the corresponding income. The implementation of SEP offers a normative solution to this imbalance by enabling Indonesia to establish taxing rights based on economic reality rather than physical form. By recognising digital interaction as a legitimate indicator of business presence, Indonesia can align its legal framework with contemporary patterns of global value creation. Such reform not only enhances revenue mobilization but also reinforces the principles of equity, neutrality, and fiscal sovereignty that underpin the modern tax system.

At its core, SEP is a legal construct that reflects the transition from a location-based to a participation-based understanding of economic nexus. In the digital economy, value generation no longer depends on factories, offices, or local agents; instead, it arises from complex interactions involving user engagement, platform algorithms, and cross-border data flows. Multinational digital corporations derive their profits by exploiting the economic potential of vast user networks in various jurisdictions. For instance, when Indonesian consumers spend time on a global platform, their activity generates data, advertising impressions, and consumer insight each of which contributes to the company’s overall revenue. Under the SEP approach, this pattern of sustained economic participation constitutes a sufficient connection to justify taxation, regardless of whether the enterprise has a fixed place of business. In this sense, SEP redefines presence in terms of economic significance rather than physical permanence, thereby realigning tax law with twenty-first-century business realities [20].

The conceptual foundation of SEP builds upon three interrelated principles: economic substance, market engagement, and fairness. First, the principle of economic substance emphasises that taxation should correspond to the location where value is truly created and where commercial benefits are realised. In the digital economy, value creation is no longer confined to production facilities but extends to intangible contributions such as user data and digital participation. Second, the notion of market engagement recognises that consumers form an integral part of the value chain. Their interactions with digital platforms generate monetisable outputs that drive profit, even in the absence of traditional business operations. Finally, fairness underlines the imperative that all economic actors whether local or foreign, physical or digital bear a proportionate fiscal responsibility for the benefits they obtain from a jurisdiction’s economy. Together, these principles provide a moral and legal rationale for the adoption of SEP in Indonesia’s tax framework [21].

However, implementing SEP is not solely a matter of conceptual evolution; it requires comprehensive legal and institutional reform. The traditional statutory language in Indonesia’s Income Tax Law must be adjusted to accommodate the notion of “economic presence” as a nexus criterion alongside, or even in place of, physical presence. Such reform should define measurable parameters that indicate significant economic engagement. These parameters may include quantitative thresholds such as the volume of online transactions involving Indonesian users, the number of subscribers or active participants within Indonesia’s digital ecosystem, or the proportion of total revenue derived from Indonesian sources. Establishing these indicators would provide objective standards for tax administration and reduce ambiguity in enforcement.

It would also align Indonesia's domestic rules with emerging international practices that evaluate digital nexus through similar economic metrics [22].

Moreover, integrating SEP into Indonesia's legal system necessitates harmonisation with existing international obligations, particularly double taxation avoidance agreements (DTAAs). Most of Indonesia's tax treaties, modeled after older versions of the OECD and UN Model Conventions, define Permanent Establishment in strictly physical terms. Consequently, unilateral introduction of SEP could create potential conflicts between domestic law and treaty provisions, leading to double taxation or disputes with treaty partners. To mitigate these risks, Indonesia may need to undertake renegotiations or contextual reinterpretations of relevant treaties to reflect the broader notion of digital presence. This process could draw inspiration from international dialogues, such as the OECD's Inclusive Framework on Base Erosion and Profit Shifting (BEPS) and the Global Minimum Tax (Pillar One and Pillar Two) initiatives, which aim to establish a coordinated multilateral solution for taxing the digital economy [23].

The normative alignment between domestic reform and international consensus is critical for maintaining legal certainty and fostering investor confidence. A unilateral SEP regime, if implemented without coordination, might invite challenges from affected enterprises or strain diplomatic relations with key trading partners. Therefore, Indonesia's legal approach to SEP should balance assertive fiscal policy with respect for international cooperation. The adoption of transitional rules, clear definitions, and procedural safeguards can help maintain predictability within the tax environment while preserving the country's right to tax digital activities occurring within its borders.

From a jurisprudential standpoint, SEP embodies the principle of substantive justice in taxation. The law, as an instrument of social order, must adapt to changing economic realities to preserve fairness and legitimacy. Just as the industrial economy of the nineteenth century required the formation of corporate and labor laws to regulate factories and physical enterprises, the digital economy of the twenty-first century demands a reconceptualization of taxation law to govern intangible and virtual transactions. By adopting SEP, Indonesia updates its legal vocabulary to reflect these transformations, ensuring that taxation remains a reflection of actual participation in national economic life [24]. This evolution signifies not merely a technical adjustment but a normative reaffirmation of the social contract between state and taxpayer: every actor that benefits from Indonesia's economy has a duty to contribute fairly to the public good.

In practical terms, SEP's implementation would enhance Indonesia's fiscal capacity without erecting new trade barriers or imposing discriminatory obligations. It extends the scope of taxable entities based on measurable economic engagement rather than nationality or physical conduct. Through this mechanism, Indonesia can fairly tax income derived from advertising revenue, digital content distribution, online marketplace transactions, and other data-driven activities that currently escape the domestic tax net. This inclusivity ensures that both local and foreign enterprises operate under comparable fiscal conditions, reinforcing competitive neutrality. Moreover, greater tax certainty arising from a clearly defined SEP regime would facilitate voluntary compliance and reduce administrative disputes, thereby improving the efficiency and credibility of tax administration [25].

Nevertheless, SEP is not without challenges. Among the most pressing are issues of identification, attribution, and enforcement. Determining the extent of a foreign enterprise's digital engagement with Indonesian users requires access to reliable data on digital transactions and market participation. Achieving this necessitates cooperation between the tax authority, digital regulators, and possibly international partners for information sharing. Attribution of profits also poses complex technical problems: once a digital nexus is established, how should Indonesia determine the proportion of global profits attributable to domestic market engagement? Various models such as formulary apportionment or fractional allocation based on user metrics have been proposed internationally, but none have achieved universal acceptance. Indonesia must, therefore, develop a pragmatic, transparent methodology compatible with both its domestic needs and evolving international standards.

Additionally, the SEP framework must be supported by robust institutional capacity and technological infrastructure. Effective administration of digital taxation depends on the ability of the Directorate General of Taxes to collect, process, and analyse large volumes of data. This requires investment in digital systems, advanced analytics, and human resource development to build expertise in cross-border taxation. Without such capacity, the effectiveness of SEP will remain limited, and enforcement risks being inconsistent. Therefore, the success of SEP implementation in Indonesia depends not only on legal reform but also on administrative modernisation and inter-agency collaboration [26].

A further consideration involves the potential economic and political implications of adopting SEP. Multinational digital enterprises may resist the reform, arguing that extended taxing rights increase compliance burdens and introduce legal uncertainty. However, these concerns can be mitigated through transparent rulemaking, public consultation, and consistency with global norms. By positioning itself as an early adopter within the region, Indonesia can strengthen its bargaining power in international tax negotiations and set a precedent for other developing economies seeking equitable participation in global digital taxation. Additionally, the increased revenue generated through SEP could support national infrastructure, education, and digital transformation agendas, thereby producing long-term economic benefits that outweigh transitional costs.

From a theoretical perspective, SEP represents not only a response to digitalization but also an evolution in the philosophy of international taxation. The traditional dichotomy between source and residence taxation relied on geographic proximity as a proxy for economic connection. SEP, however, redefines this relationship by recognising the virtual presence of enterprises as an equally legitimate form of economic participation. This conception aligns with modern notions of functional sovereignty, whereby a state's jurisdiction extends to activities that materially affect its economy, regardless of physical boundaries. In doing so, SEP harmonises with emerging global norms that emphasise substance over form, bridging the gap between legal doctrine and the realities of a digitally integrated world [27].

Importantly, the adoption of SEP also reinforces Indonesia's commitment to fiscal sovereignty a state's inherent right to design and enforce taxation policy within its territory. Digitalization challenges this sovereignty by enabling profit shifting and reducing the state's capacity to tax economic value generated by its citizens and resources. By implementing SEP, Indonesia asserts its right to adapt its tax nexus to contemporary conditions, ensuring that national interests are not undermined by outdated international norms. This assertion of sovereignty, however, must be tempered with adherence to principles of cooperation and equity to avoid unilateralism that could destabilise the international tax order [28].

In conclusion, the adoption of the Significant Economic Presence principle offers Indonesia a coherent legal mechanism to modernize its taxation system and safeguard fiscal justice in the face of rapid digital transformation. It responds directly to the deficiencies of the traditional Permanent Establishment framework by redefining taxable presence through measurable indicators of digital participation. Properly implemented, SEP can provide both legal certainty and policy flexibility ensuring that taxation reflects real economic contributions within Indonesia's digital ecosystem. To achieve this, the reform must be embedded within an integrated legal strategy that harmonises domestic legislation, international treaty obligations, and administrative capacity. By doing so, Indonesia will not only strengthen its fiscal base but also reaffirm its role as a sovereign, equitable, and forward-looking participant in the evolving architecture of global taxation.

5. Conclusion

The development of the digital economy fundamentally challenges the adequacy of Indonesia's traditional taxation framework, particularly the concept of Permanent Establishment (PE), which remains anchored in physical presence. The analysis demonstrates that this conventional approach fails to capture the economic realities of cross-border digital activities, resulting in revenue loss and diminished fiscal sovereignty. To address these structural deficiencies, the adoption of the Significant Economic Presence (SEP) principle is both necessary and justified. SEP provides a modern legal instrument that realigns taxation with the substance of value creation and market participation, establishing a fair and effective nexus for taxing digital enterprises. However, successful implementation requires comprehensive legal reconstruction, harmonisation with international tax treaties, and strengthening of administrative capacity. By embracing SEP, Indonesia can advance a more equitable, adaptive, and sovereign tax regime. Nevertheless, this study acknowledges limitations, including its doctrinal nature, lack of empirical data on SEP implementation in comparable jurisdictions, and underexplored treaty interactions. Therefore, future research should pursue empirical investigations into SEP's economic and administrative impacts, comparative legal analyses of treaty compatibility, case studies on enforcement challenges, and simulation-based modelling of revenue effects. Addressing these avenues will complement the present findings and provide more granular guidance for Indonesia's tax reform efforts. Ultimately, this reform reaffirms the principle that taxation must correspond to genuine economic engagement and contribute to national development within a globally connected marketplace.

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