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Local Government Taxing Power for Digital Consumption: A Case Study of Hotel, Restaurant, and Entertainment Taxes in Indonesia

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Abstract Limited tax collection authority in local self-governments hampers revenue generation in rural regions with smaller populations and limited commercial activity, while the growth of the digital economy further complicates tax collection for local governments. The objective of this study is to examine the challenges encountered by both the central and local tax administrations in Indonesia when implementing consumption-based taxation, especially in light of the increasing prevalence of digital transactions. The study reveals that the shift from traditional to digital transactions is likely to result in conflicting taxing rights between central and local governments. Local governments are typically entitled to a share of taxes on certain forms of consumption, such as accommodation, food delivery, and entertainment. However, the use of digital platforms to provide these services has significantly reduced the local government's share of tax revenue. This issue is exacerbated when the central tax administration, with its competitive advantage, administers the transaction alongside the broader value-added tax object. In addition to the unclear tax-sharing arrangement, the underlying problem consists in the inadequate coverage of all digital transactions, potentially leading to revenue leakage and double non-taxation.

Keywords: • taxing power • consumption-based tax • local tax • digital economy • Indonesia

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1 Introduction

In jurisdictions where both central and local tax systems are in place, such as in the context of consumption-based tax, there may be an overlap in taxing powers, particularly in the digital age. This can arise due to the evolving nature of digital consumption, which often transcends geographical boundaries and poses challenges for tax authorities to accurately determine the appropriate taxing jurisdiction (Agrawal & Fox, 2021). Value-added tax (VAT) is a widely used multi-stage consumption-based tax (Bahl, 2008; Nutman et al., 2022), and it is also commonly used to tax the digital economy in many countries (Beebeejaun, 2021; Mpofu, 2022). VAT is guided by key fiscal policy principles, such as neutrality, efficiency, certainty, simplicity, and effectiveness (Hodžić & Celebi, 2017).

When VAT is imposed on cross-border transactions that take place at both the international and intra-federation levels, revenue is assigned to the 'place of taxation,' which has two rather distinct meanings (Yesegat & Krever, 2018). The 'destination principle' is commonly used to tax final consumption at the point of incidence, where the place of taxation is where final consumption occurs (Brondolo & Konza, 2021). However, some jurisdictions use an 'origin-based' approach based on the location of suppliers. Indonesia fully follows the destination principle as defined in Article 4 of the VAT Law (Saptono et al., 2021), without any exceptions.

In Indonesia, VAT is a central tax the central government administers, while local governments administer local taxes. This distinction determines who is granted authority to collect taxes, how tax revenues are used, and how double taxation on goods or services can be avoided (Rosdiana & Irianto, 2014). For example, VAT is not levied on food and beverages supplied in hotels, restaurants, and similar establishments subject to local taxes to avoid double taxation. Fiscal decentralization in Indonesia aims to empower local governments with control over their spending budgets by transferring revenue sources such as taxing rights to them. However, local governments are currently only granted authority to collect modest taxes on certain items, primarily in metropolitan cities, making it difficult for rural areas with lower populations and limited commercial activity to generate revenue (Nasution, 2016). Unfortunately, most major local-own revenues, such as hotel taxes, restaurants, entertainment, and streetlights, are only significant in metropolitan cities and tourist destinations. As a result, many regions heavily rely on funds from the central government.

On the other hand, the growth of the digital economy has affected the central government's tax-sharing arrangement with local governments, as digital transactions and services have become more difficult to tax (Fox & Murray, 2004). Several studies have proposed a digital service tax (DST) as a response to the problems with taxing the digital economy (Kim, 2020), how the DST controversy originated by exposing the Facebook case (Fishbien, 2019), and there have been debates and discussions on the effectiveness of DST legislation in various countries, including the European Union (Kennedy, 2019; Salis, 2021). Recent studies have also attempted to determine the impact of e-commerce on EU tax legislation, particularly VAT (Hodžić, 2022; Tofan & Bostan, 2022). The EU has been at the forefront of efforts to introduce a consumption tax in the digital realm (Ligthart, 2005). Despite previous attempts, implementing DST or other measures to effectively tax the digital economy remains a complex and evolving issue that requires careful monitoring and consideration of various proposals. In light of the above stated, the research hypothesis is: “The rise of digital consumption facilitated by digital platforms complicates the issue of local government taxing power in Indonesia”. In order to confirm or reject the research hypothesis, library research methodology as well as authors’ documentation from tax practices in the field were used.

Building upon the background presented above and recognizing the existing research gap, this paper addresses local governments’ challenges in taxing several types of consumption in the digital economy. Our research fills a critical void in the literature by specifically examining the aspect of consumption-based taxes for digital consumption, such as those levied on hotels, food, and entertainment services. It underscores the pressing need for tax reform in this domain. These taxes are defined under Article 4A of the latest version of the VAT Law as outlined in Law No. 7 of 2021 concerning the Harmonization of Tax Regulations (HPP Law). This focus is justified by the direct influence of the digital economy on these taxes. By means of this paper, we aim to contribute to the ongoing efforts towards tax system reform, making it more responsive and adaptable to the disruptions brought about by digital technology.

2 Literature overview

Digital technology has significantly impacted the tax environment, bringing forth new challenges and opportunities for revenue authorities, as well as governments and policymakers. As the digital economy grows, technology advances, and business models evolve, tax administrators must find ways to productively tax the digital sector (Mpofu, 2022), or a significant amount of tax revenue will go uncollected. This poses a challenge, especially for many developing countries that rely heavily on corporate tax and VAT to fund government expenditure (Bahl & Bird, 2008; Bird & Zolt, 2008). The issue of which is the most effective method or tax head to use to tax the digital economy remains hotly contested among stakeholders such as academics, governments, and tax authorities.

The tax environment has been significantly impacted by digital technology, presenting new challenges and opportunities for revenue authorities, governments, and policymakers. With the growth of the digital economy, advancements in technology and changes in business models, tax administrators must find effective ways to tax the digital sector to ensure that tax revenue is collected in a productive manner (Mpofu, 2022). This challenge is particularly relevant for developing countries that heavily rely on corporate tax and VAT as sources of funding for government expenditure (Bahl & Bird, 2008; Bird & Zolt, 2008). The debate over the most effective digital economy taxing method remains contentious among stakeholders, including academics, governments, and tax authorities (Hodžić, 2022; Kim, 2020; Tofan & Bostan, 2022).

Rosenthal et al. (2022) underscore the challenges restaurants and third-party food delivery companies face in determining responsibility for collecting and remittance sales tax, particularly when local restaurant-related taxes are involved. They highlight the importance of reviewing local tax ordinances, contract agreements, and reconciliation reports to ensure compliance and avoid potential double taxation. On the other hand, van Zyl (2009) discusses the challenges in taxing intangible digital goods and services, such as music, due to their ease of transfer. The author suggests that adopting the VAT calculation models of the OECD and EU, which treat digital goods and services as supplies of services and levy VAT based on the place of consumption, may simplify compliance. However, the author also highlights potential challenges in implementing these models, such as the classification of digital goods as goods for VAT purposes and the registration of non-resident vendors in jurisdictions of consumption.

Beebeejaun (2021)'s review shows that taxes on digital services have multiple impacts. These include hindrances to affordability for consumers, decreased investment in infrastructure by foreign suppliers, a slowdown in the adoption of new technology in countries with digital taxes, and the rise of abusive tax avoidance practices, resulting in loss of tax revenue for host countries where digital services are offered. Governments that levy digital taxes must carefully consider the trade-offs between tax revenue and the potential negative impacts of such taxes on digital development (Ndulu et al., 2021). As a result, it is crucial to draft digital tax laws to promote efficient tax collection, prevent excessive taxation of digital activities, and minimize adverse effects on the country's economy (Beebeejaun, 2021).

2.1 Taxing powers regarding consumption-based tax

The optimal placement of a consumption-based tax in a fiscal system is as a central tax, since that sort of tax possesses the natural advantages of a central tax (Sheng, 2017). By maintaining VAT centralized, most nations have avoided the challenges that may arise if they choose to decentralize VAT (Wójtowicz, 2015). Yet, several federal and unitary countries have decentralized VAT at various levels and methods.

Bird (2013) provides examples of several nations that have used VAT decentralization and the elements addressed while implementing this policy.

Germany and Morocco distribute a percentage of the collected VAT to local governments based on some characteristics, including population and poverty. In Argentina and Colombia, the transferred funds comprise a percentage of all central tax income, including VAT. China, like Russia, attempts to allocate the province's share of VAT on a "derivation" basis (origin principle), that is, a consistent share ratio applied to all jurisdictions based on the actual VAT revenue collected by the central government in each jurisdiction (Zee, 2008). Other nations, including Spain and Japan, allocate a regional share based on 'final' consumption estimates in the region's jurisdiction. For administrative or incentive purposes, countries like Portugal and Mexico implement different tax rates in particular areas (Bird, 2013).

Competition for taxing rights on the delivery of goods and services between regions is the fundamental obstacle to the introduction of VAT at the local government level. Without this regulation over cross-border trade, the VAT levied by the exporting jurisdiction will apply to goods imported from other regions. Consequently, an independently administered regional VAT system would necessitate taxes based on origin instead of the destination principle. However, VAT based on the origin principle is not only more vulnerable to tax competition (e.g., through various forms of transfer pricing) compared to the destination principle (e.g., producers are more mobile than consumers), but it is also less compliant with the benefit principle, which has traditionally guided the design of tax-sharing arrangements (Zee, 2008).

Determining VAT rates and revenue-sharing ratios between central and regional levels of government can be challenging due to regional inequalities in terms of population, income, and expenditure. Many emerging countries facing VAT-sharing concerns often struggle with regional inequities (Wójtowicz, 2015). Other issues should be taken into account as well. The high administrative and compliance costs of taxation by two authorities on the same basis and the unjustifiable limitation on the scope of central macroeconomic policy by separating tax prerogatives across many government levels are other issues. There are also concerns that the central government may be reluctant to hand over a sizable VAT base for use by local government levels, since it is very attractive (Bird, 2013).

2.2 The structure of central and local revenue of Indonesia

Article 23 (1) of the 1945 Constitution, which pertains to the State Budget Revenue and Expenditure, commonly known as APBN, contains the regulations governing Indonesia's state budget. APBN is the annual financial plan of the government, which the House of Representatives approves. It serves as the central government's roadmap for promoting sustainable development outcomes and implementing fiscal decentralization. The current term of Indonesia's state budget spans one year, from 1 January to 31 December. The structure of APBN comprises five main components: state revenues, state expenditures, primary balance (the difference between income and expenditure excluding debt interest), budget surplus/deficit (the difference between revenues and expenditures), and financing from domestic and foreign sources.

The structure and performance of the central and local revenue budget for the years 2019-2021 are presented in Appendix (Table 1). Tax revenue constitutes a significant portion, accounting for nearly 80% of the total central revenue. However, the pandemic's impact and the decline in economic activities led to a decrease of approximately 16.9% in tax revenue realization in 2020. This sharp decline in tax revenue raises concerns about funding vital economic and health initiatives to combat COVID-19 (Khozen & Setyowati, 2023). Nevertheless, there was a 20.4% increase in tax collection in 2021 compared to the previous year, indicating a potential turning point to pre-pandemic levels. The realization of tax revenues includes tax, customs and excise revenues. Most of the major sectors that contributed to tax revenue experienced an increase, which was influenced by the utilization of high tax stimulus measures. Among the types of taxes collected by the central government, income tax accounts for the largest portion, followed by revenue from VAT.

Non-tax revenue sources typically contribute around 20% of central government revenue, primarily from natural resources, state-owned assets, other non-tax revenue, and public service agencies. However, due to the severe impact of the COVID-19 pandemic, non-tax revenue decreased by 15.9% in the fiscal year of 2020 compared to the previous year, but showed a significant recovery with a growth of 31.4% in 2021. The growth in 2021 was mainly driven by increased revenues from natural resources, other non-tax revenue, and revenues from public service agencies. The decline in non-tax revenue from state-owned assets was influenced by the pandemic's effect on dividend payments from state-owned enterprises. Additionally, grant revenue reached its highest level in 2020, primarily due to increased funding associated with the pandemic and improved reporting by ministries and state agencies.

The fiscal relationship between the central and local governments in Indonesia is characterized by a high degree of central control over the regional development process (Sudarti, 1998), as indicated by the small percentage of own-source revenue relative to transfers from the fiscal balance. As shown in Table 1, local revenue budgets in Indonesia only contributed about 14.1% of own-source revenue over the past three years, while transfers from the central government accounted for 57.9%. The major sources of own-source revenue for local governments in Indonesia include local taxes, user fees, and profits from locally-owned enterprises. The central government establishes tax bases and maximum rates for user fees. Local governments can levy taxes and fees at rates up to these maximums based on local regulations and policies for regional development interests (Lewis, 2006).

However, local governments lack the authority to levy and collect major sources of revenue, such as personal income tax, corporate tax, customs and excise, and sales tax, as these are maintained by the central government (Nasution, 2016). This reflects the significant centralization in the tax system in Indonesia (Sudarti, 1998). Local resources, such as hotel, entertainment, restaurant, and parking taxes, have the potential to generate more revenue (Arintoko & Bawono, 2021). However, these resources are not distributed equitably enough to support the fiscal capabilities of most local governments. Sufficient funding is essential for local self-government to ensure an equitable allocation of responsibilities pertaining to public spaces, property, and services (Plzáková & Studnička, 2021). Moreover, digital developments may further distort their abilities, as the overlap of central-local taxation powers occurs amidst local governments' lack of human resources and technology to administer consumption types that have transitioned to become digital in nature. Finally, the central government can easily classify these resources as objects for centrally-collected VAT.

3 Research method

This study analyzes the outcomes with which local governments of Indonesia are confronted when attempting to tax various types of consumption, i.e., hotel, food, and entertainment services in the digital economy. Economic digitalization has altered numerous facets and ways of our daily lives while also establishing a foundation for varied research practices to address the inherent issues. Therefore, this study applied a library research methodology by assessing several scientific journals, books, laws and regulations, academic papers of draft legislation, and other pertinent library materials to address the challenges of the digital age. The primary data sources for this study include VAT and local tax statutes, regulations, rules, academic papers, and legal cases, while the secondary data were collected from journal articles, textbooks, online newspapers, and authors' documentation from tax practices in the field. The more sources authors engage with in this inquiry, the better positioned they become. This is because the findings of previous studies serve as the foundation, background, and context for the current research (Tsai, 2014).

The content analysis approach offered a more detailed view of the phenomenon. It was used to gather data by quoting, modifying, and assessing representative literature relevant to the topic in question. Correspondingly, it was determined which additional sources are necessary and repeated the relevant steps to identify them and obtain them from the library source. As George (2008) suggested, the source is evaluated to create an argument in the library research inquiry. The best way to evaluate any source is to compare each item from the source to the study's objective. This research holds firmly that sources precede and support an argument, not vice versa. However, to avoid relying on the inventory of arguments from the previous literature, as is the case with this approach (George, 2008), the sources were combined with insights from field observations. The observation focuses on the accommodation, food and beverage, and entertainment industries with a view to their conformity with the tax legislation and principles gathered from the library. Invoices from interactions with digital services were compiled, the evidence gathered was used, and important notes about fulfilled tax requirements were made.

4 Results and discussion

4.1 Taxing powers for the digital age: the case of Indonesia

Indonesia has the option to adopt a general VAT autonomy system, where taxes are paid based on the location of goods production, i.e., origin-based. However, in the absence of consistent tax rates across different regions, there is a possibility that taxpayers may relocate their businesses to areas with lower tax rates, a phenomenon known as 'fiscal war', as observed in Brazil (de Carvalho, 2016). In China, the VAT system follows an origin-based production tax model that excludes certain services from the tax base, as they are subject to a separate company tax imposed by local governments. However, this VAT proposal has been criticized for its negative effects on export competitiveness, investment, and for causing cascading distortions and local protectionism (Wong & Bird, 2008).

Indonesia may not be suitable for implementing an origin-based tax system due to the uneven distribution of industrial centers across different regions, with certain areas being more concentrated than others. Production centers are typically located in western Indonesia, resulting in significant disparities in eastern Indonesia. To effectively implement a consumption-based tax system, a well-structured administrative and coordination framework based on a destination-based approach is required between the regions and the central government to ensure equitable distribution of VAT revenues. This necessitates efficient information exchange for compliance checking among regions and with the central government (Safitra et al., 2020).

One possible approach for a consumption-based tax system is to simultaneously divide the VAT tax base or simply divide the tax revenue between the central and local governments (Zee, 2008). In the case of Indonesia, local governments have been granted taxing rights over various types of consumption-based taxes in addition to VAT and sales tax on luxury goods. The transfer of taxing authority to local governments is achieved through decentralizing the tax base for different types of consumption, as outlined in Article 4A, paragraphs (2) and (3) of the VAT Law, as last amended by the HPP Law.

As per Article 4A of the HPP Law, local governments in Indonesia are responsible for the collection of taxes on specific goods and services, which include (1) food and beverages served in hotels, restaurants, food stalls, and similar establishments, (2) arts and entertainment services, (3) hotel services, (4) parking space provision services, and (5) catering services. These categories of goods and services are governed by Law No. 28 of 2009 on Regional Taxes and Levies (PDRD Law), particularly the taxes related to hotels, restaurants, entertainment, and parking. However, upon the introduction of Law No. 1 of 2022 concerning Financial Relations between Central and Regional Government (HKPD Law), which replaces the PDRD Law, a new term called "Specific Goods and Services Tax" (PBJT) was introduced. The responsibility for tax collection lies with the regency/city, except in areas that are not separated into regencies/municipalities, such as DKI Jakarta, where the province is responsible for tax collection. However, it should be noted that the HPP Law explicitly specifies that the five categories of goods and services mentioned above are subject to municipal taxes and are exempt from VAT.

The continuous assessment of policies and supportive actions, as well as the collective capacity to adapt to evolving domestic and global conditions are required in the process of local and regional restructuring (Nahtigal, 2022). The advent of the digital economy has brought about significant changes in how consumption taxes are collected by local governments, leading to several challenges that could result in revenue losses. One of the key challenges is the lack of clarity in defining tax objects and the limited taxation authority of local governments, which further complicates the issue. Using algorithms in digital technology has revolutionized how consumers engage in digital transactions, offering convenience but altering traditional tax administration processes (Khozen et al., 2021). Additionally, the outdated bureaucratic model that influences tax administration at both central and local levels has resulted in a lag in tax administration, keeping up with the rapid growth of the business world.

The sharing-economy business model, in particular, poses complex issues that legislators have not adequately addressed (Hodžić, 2019; Kaplan & Nadler, 2017). Therefore, it is essential to examine the prospects and future directions of various types of consumption taxes administered by local governments in light of the increasing prevalence of digital transactions. Among these taxes, hotel, restaurant, and entertainment taxes are expected to face challenges, especially due to the diverse nature of tax objects. However, parking tax has been excluded from the analysis as digital transactions are not expected to significantly impact this type of tax. Similarly, billboard and electricity consumption taxes are not within the scope of this study as they are not covered by central tax legislation (VAT Law).

4.1.1 Hotel tax

According to Law Number 1 of 2022 (HKPD Law), a new tax called PBJT (Certain Goods and Services Tax) has been introduced. PBJT is defined as a tax paid by the final consumer for certain goods and/or services. This new tax simplifies several previous types of taxes, including hotel, restaurant, and entertainment taxes. Under the new law, the tax base for PBJT is the amount paid by consumers for certain goods or services. For instance, the tax base for hotel tax is the amount paid by consumers for hotel services. This definition is more straightforward compared to the previous regime (Law Number 28 of 2009 or PDRD Law), where the tax base for hotel tax was defined as the amount of payment made or required to be made to the hotel. Although the tax office's discretion is reduced in the new regime by eliminating the possibility of setting the 'price that should be paid,' the new law broadens the definition of what can be subject to hotel tax (as one of the sub-PBJT). It includes various accommodations such as hotels, hostels, villas, motels, inns, guest houses, resorts, cottages, private residences functioning as hotels, and glamping. On the other hand, the tax objects for hotel tax under the regime of Law 28 of 2009 (PDRD Law) were services provided by hotels with payment, including supporting services like telephone, internet, photocopying, transportation, and entertainment facilities. Meanwhile, some services were exempted from hotel tax under the previous law, such as hostel accommodation services provided by the Government or Regional Government, rental services for apartments and condominiums, housing services at education or religious activity centers, and travel agency services organized by hotels. The new tax law aims to simplify the tax system and ensure a more consistent application of taxes on certain goods and services.

The sharing economy, characterized by digital platforms such as Booking.com, Airbnb, Uber and other platform providers, has emerged as a modern phenomenon that has increased societal abundance by making it easier for individuals to expand their relationships and find accommodation that fits their budget (Geissinger et al., 2018; Muller, 2020; Trabucchi et al., 2021). However, this has also raised concerns for governments, particularly in the hotel industry, regarding the rise of illegal hotels operated through digital platforms, such as Airbnb, where landlords in cities like New York City attempt to evict tenants to convert units into full-service hotels (Kaplan & Nadler, 2017). Despite these concerns, Airbnb has refused to engage with city officials to address the issue, citing potential negative impacts on its revenue and earnings (Muller, 2020).

To tackle tax evasion and fraud, the government can leverage digital technology to streamline administrative processes and enhance tax compliance (Plzáková & Studnička, 2021). Integrating tax administration with technology can reduce compliance costs for taxpayers and tax authorities and make it easier to collect taxes from the hotel industry, which has a large disparity in the number of tax authorities and the size of the industry in each region, as seen in Indonesia (Saptono et al., 2023). Furthermore, the rapid development of digital technology has led to the creation of apps that allow users to rent apartments and condos for short-term stays, making it crucial to include these types of accommodations in the scope of the hotel tax (BK-DPR, 2020). For instance, Article 32 (3) of the PDRD Law did not include rental services for apartments, condominiums, or dormitories as hotel-tax objects. The recent changes through the HKPD Law have expanded the scope of taxable services to include rental services for apartments, condominiums, and dormitories, previously not included as taxable objects under the PDRD Law. This modification presents an opportunity for local governments to increase their revenue by capturing potential gains from these previously untaxed accommodations.

According to the report of the Indonesian Central Bureau of Statistics (BPS, 2021), the number of business actors providing lodging/accommodation services in Indonesia for 2020 (before the introduction of Law Number 1 of 2022) was 30,823 businesses, or based on the number of rooms, there were 870,783 rooms. Of these number of accommodations, only 3,644 (11.82%) were hotel businesses and were subject to hotel tax. Therefore, the expansion of the hotel tax base brought about by Law Number 1 of 2022, which includes a wider range of accommodation types and facilities as hotel tax objects, will multiply regional revenues from this sector to several times more than at that time. The number of accommodations formerly exempt from hotel tax was much higher than the tax base at the time, with only a small percentage of accommodation services included in the scope of the taxable hotel industry (BPS, 2021). Expanding the tax base to cover accommodation services can potentially increase local government revenue from the sector multiple times over, strengthening their fiscal capacity, as in the case in the Czech Republic (Plzáková & Studnička, 2021).

However, the issue of tax rates remains unresolved despite the current amendment, with concerns the equitable distribution among business actors, particularly small-scale hoteliers with varying capacities and competitiveness (KPPOD, 2021). Tax rate policies must be adjusted to the scale of the hospitality industry, considering the compliance of small hoteliers, who may be beyond the reach of the tax administration (KPPOD, 2021). Local governments have the flexibility to determine tax rates based on their political will, and offering a range of options may encourage tax compliance among small industries, considering the association between lower tax rates and compliance as supported by previous literature (Alm & Malézieux, 2021; Morton et al., 2022). Thus, careful consideration of tax rates compatible with the capabilities of business actors is necessary under the HKPD Law (KPPOD, 2021).

4.1.2 Restaurant tax

According to Article 50 of Law Number 1 of 2022, PBJT includes the sale and/or delivery of food and/or drinks provided by restaurants or catering service providers. The tax base for this tax is the amount paid by consumers to the restaurant or catering service providers. This definition is simpler than the one in the previous regime (Law Number 28 of 2009 or PDRD Law), where the tax base for the restaurant tax was defined as the amount of payment made or that should be made to the restaurant. According to Article 51(1) of Law Number 1 of 2022, the sales and/or delivery of food and/or drinks subject to PBJT taxes include those provided by restaurants that offer food and/or serving services, beverages with tables, chairs, and/or eating and drinking utensils, as well as catering or catering service providers that conduct various processes like supplying raw materials, manufacturing, storing, and serving based on orders. The presentation is done at the customer's desired location, different from where the manufacturing and storage processes take place, and can be with or without equipment and staff. Instead of using the term 'restaurant tax' as in the PDRD Law regime, the current law emphasizes the activities as 'Sale and/or delivery of Food and/or Beverages,' allowing it to cover a wider range of business actors, namely 'restaurants or catering service providers'.

Online food delivery services have experienced significant growth, especially since the pandemic, when people's mobility drastically reduced. As a result, this digital development has become the preferred alternative for many. Based on a report by Statista (2022), the online food delivery services market in Indonesia is valued at US$ 1,055 million and is expected to grow at approximately 13% per year. This growth is expected to accelerate further in the aftermath of the pandemic. The high valuation of food delivery services in Indonesia is attributed to the widespread adoption of delivery services by local restaurants such as GoFood, GrabFood, and ShopeeFood, as well as large businesses like Pizza Hut and McDonald's that operate their own delivery services.

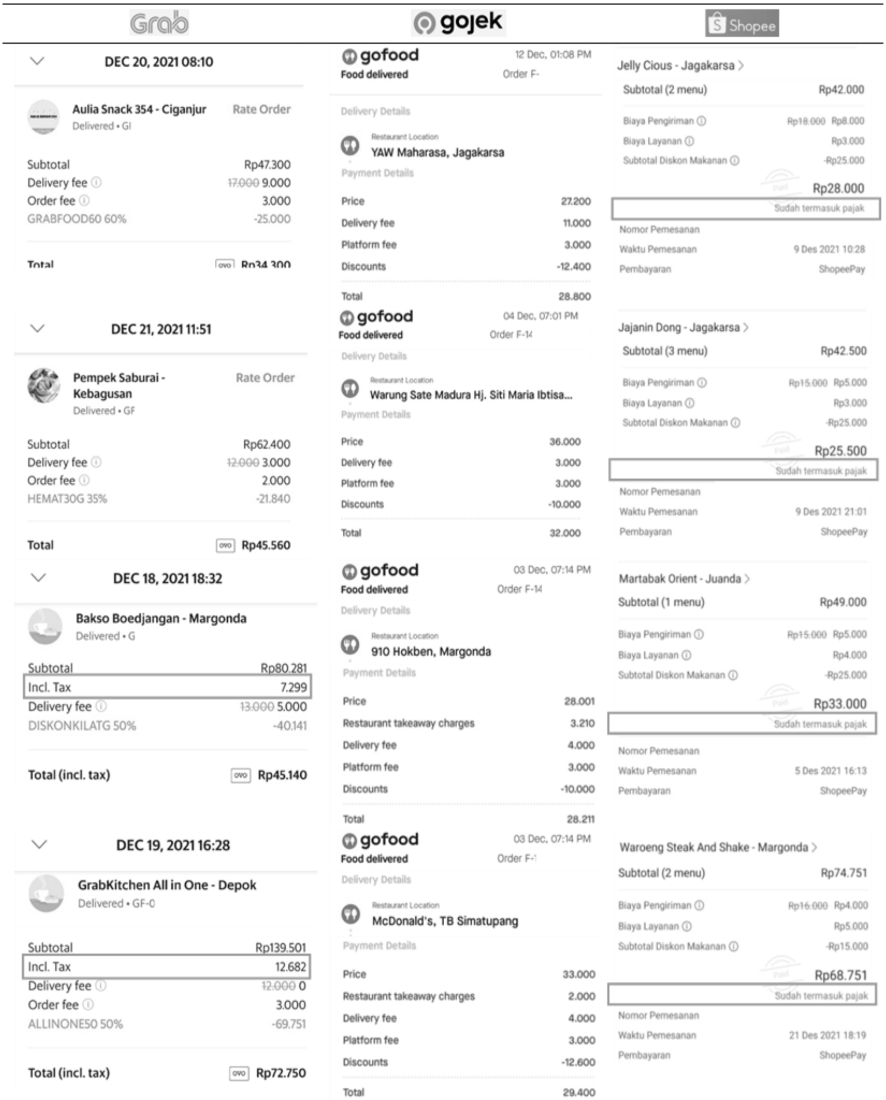
A survey conducted by Katadata Insight Center revealed that 44% of respondents who used online food delivery services during the pandemic were first-time consumers, and they expressed interest in continuing to order meals online even after the pandemic ended (Katadata.co.id, 2021). These findings are consistent with previous research that the quality of food and e-service providers' service also indirectly affects customer happiness and loyalty (Suhartanto et al., 2019). As a result, price wars among digital service providers have become common in the industry. Additionally, some platforms may invest additional capital in stabilizing the market and maintaining their customer base, as seen in India (Mondal, 2021).

India, being the most populated country in the world, faces a significant challenge with revenue leakage from restaurants due to tax evasion. While major restaurants find it simple to charge the 5% Goods and Services Tax (GST), small restaurants with less than 20 lakhs in revenue have faced challenges in collecting taxes and complying with tax requirements (Aldeia, 2019; Mondal, 2021). To address this issue, India's GST Council, through the Ministry of Finance, has issued a new directive requiring online food delivery platforms to collect and pay 5% GST starting in 2021 instead of restaurant operators (Mondal, 2021).

Similar to India, Indonesia has also faced a long and winding road with restaurant taxes, as evident from invoice samples provided by GrabFood, GoFood, and ShopeeFood in December 2021 (Figure 1). Platform or merchant policies may generate tax-related information as a tentative component. GrabFood only includes tax information for major restaurant transactions. Small restaurant purchases do not encompass this information, possibly because the sales value does not reach the local authority's limit outlined in Article 37 (3) of PDRD Law, which varies across regions. Tax information is not accessible for purchases made through GoFood, regardless of whether for large or small restaurants. Unlike GoFood, ShopeeFood purchases feature 'Include tax' information without regard to restaurant size. However, on the invoice from ShopeeFood, there are no specifics about the tax collected.

The summary in Figure 1 outlines the findings and proposes further directions. One notable difference is that GrabFood provides more transparent information about restaurant taxes compared to its competitors. This suggests that small restaurants may not have considered restaurant taxes in their selling prices. However, this needs to be verified since ShopeeFood and GoFood also appear to have already incorporated taxes into their pricing, as a manual comparison of food prices for the same merchant on all three apps shows similarities. However, the key finding is that these platforms do not seem to be involved in addressing merchant restaurant tax issues, allowing merchants freely (not) to collect and deposit taxes, possibly as a way to comply with Article 38 (2), which states that restaurant taxpayers are responsible for their own taxes.

Figure 1: Restaurant tax inclusion on sample invoices from some food delivery services



Source: Authors' own elaboration, based on personal experiences of using several platforms, 2021.

In addition to regulatory loopholes, platform providers should prioritize good faith. All businesses, including platform providers, must comply with local tax laws by regularly submitting tax returns and paying or reporting taxes (Aldeia, 2019). However, in reality, collecting restaurant tax can be challenging (Runiawati et al., 2019). Some restaurants do not pay taxes based on their actual tax potential. Some restaurant owners, including those in catering, have not even registered their businesses, resulting in government revenue losses. To address this issue, the administration of restaurant taxes should be digitalized and codified in legislation (KPPOD, 2021). At least two procedures should be implemented to prevent further loss of restaurant tax revenues. Firstly, the regulatory framework should require platform providers to share local transaction data with local authorities. The tax authority of Malang City in East Java Province, for instance, has taken measures towards this approach by requesting tax data from platform providers' merchants in the city. However, the platform provider has been unwilling to provide such information, citing concerns about personal data protection under Government Regulation No. 80/2019 concerning Trading Through Electronic Systems (PMSE).

On the other hand, local governments are not specifically authorized by the HKPD Law to request such information. According to the law, taxpayer data must only be revealed by the taxpayer (restaurant business actor). Article 103 of the HKPD Law ensures the confidentiality of taxpayer data, imposing penalties such as imprisonment and fines on officials who breach this confidentiality. Therefore, a new policy may be needed to allow for taxpayer data and information sharing in this context.

Another approach to improve restaurant tax collection in Indonesia is to have platform providers take on the responsibility of collecting and depositing taxes, similar to the system in India, which has been successful in minimizing revenue leakage, increasing transparency, boosting local revenues, and making taxation more reasonable (Mondal, 2021). Defining platform providers as tax collectors would encourage unregistered businesses to report their tax income. This arrangement would prevent restaurants from misusing customer taxes for their own benefit, as taxes collected would go directly to the government treasury through the platform rather than through the restaurants. To implement this system, Article 56 of the HKPD Law regarding taxpayer base may need to be amended or extended to allow platform providers to collect and deposit taxes. However, it is important to consider potential disincentives for platforms, as this type of arrangement could require them to meet tighter proof requirements (Messina, 2021).

4.1.3 Entertainment tax

The tax base for entertainment tax is the amount paid by consumers to the entertainment service provider. This definition is simpler compared to the previous regime (Law Number 28 of 2009 or PDRD Law), where the tax base of the entertainment tax was defined as the amount of payment made or that should be made to the entertainment provider. According to Article 55 (1) of Law Number 1 of 2022, arts and entertainment services subject to PBJT taxes include various activities such as movies, live performances, beauty contests, exhibitions, sports games, recreational rides, massage, and discotheques and steam baths/spas. However, there are exemptions for promoting traditional culture, community service activities, and other forms of art and entertainment regulated by local regulations.

The film, music, and performing arts sectors have been greatly impacted by social distancing policies implemented during the COVID-19 pandemic. Before the pandemic, traditional venues such as theaters, studios, movie theaters and golf resorts were the main platforms for entertainment. However, the pandemic, along with the rise of the digital era, has forced artists to adapt in order to survive. This has meant reevaluating and redefining their artistic and creative strengths to keep up with digital advancements, leading to a shift towards online entertainment. The increasing preference for online art viewing has further supported this trend.

As the entertainment industry has moved online, the tax landscape has also evolved, with various forms of online entertainment now becoming taxable objects. For example, watching movies on platforms like Netflix (referred to as e-movies), attending virtual music concerts (referred to as e-concerts), and even ordering massage services through apps like Salon by Houzcall, Go-Massage, Soothe: *in Home Massage*, and Fave: *Deals & Cashback*, have all become subject to potential entertainment tax. In some states and cities in the United States, this has been commonly referred to as the ‘Netflix tax’, where a sales and use tax has been imposed on the digital streaming of shows, movies, music, and games (Kim, 2020).

According to Article 59 (2) of the HKPD Law, the entertainment tax is typically payable in the area where the entertainment is performed, following the vendor/supplier collection method. For example, in Indonesia, viewing e-movies on platforms like GoPlay and Vidio.com, which charge a fee, may be subject to entertainment tax as long as it does not overlap with the central government’s Value-Added Tax (VAT). Similarly, for e-concerts, event organizers are responsible for collecting and depositing entertainment taxes. However, monitoring the compliance of event organizers with their tax obligations, whether it be entertainment taxes or VAT, can be challenging. On the other hand, for e-movies, it can be assumed that VAT has been collected, as the central tax authority has appointed a PMSE collector as a mechanism for tax collection.

Tax collection for e-concert organizers outside of Indonesia’s jurisdiction can be another challenge. However, Indonesia can learn from other countries by requiring non-resident business actors to register, charge, and pay VAT on their goods and services when selling to customers in other countries, a method known as supplier collection (OECD, 2017). Making the VAT collection process more efficient through online marketplaces can improve compliance and tax collection (Papis-Almansa, 2019). The destination principle justifies this recommendation, ensuring that VAT is only collected in countries where the final consumption occurs.

Given the administrative burden of importing cross-border entertainment services, it may be preferable to have the tax collection of e-concerts determined by the central government rather than applying it as a locally administered entertainment tax. Drawing insight from Brondolo and Konza (2021), the central tax authority could take the following measures: (1) establish a definition that covers digital entertainment services; (2) provide simplified methods for non-resident business actors to register, charge, and pay VAT in Indonesia; and (3) apply effective methods to identify non-compliant business actors.

On the other hand, there may be questions regarding the taxation of massage services delivered via digital ordering platforms such as Salon by Houzcall and similar services, as to whether they are subject to central or local taxation. Considering the philosophy of classifying massage parlor services as a ‘sin tax’ (KPPOD, 2021), it is likely that digitally obtained massage services would not be subject to the local entertainment tax regime. Thus, it would be more suitable to levy taxing rights regarding massage services provided via a digital platform that does not represent massage parlors by the central government by appointing a platform provider as a VAT collector. However, under the new regime established by the HKPD Law, massage parlors have been excluded from the ‘sin tax’ group, which raises the question of whether the local authority can collect taxes. This policy is noteworthy regarding tax rates, as massage services are subject to a 10% tax, compared to the previous rate, which could reach 75%. The collecting authority can be distinguished based on taxing power, particularly for services that can be ordered digitally. Maintaining taxation power for local governments may not be a problem if the massage service provider also owns the platform (salon-to-customer), as in the case of Salon by Houzcall, which is similar to the Pizza Hut Delivery business model. Tax collection by the central government is favored in the case of platforms that serve as a marketplace linking consumers and massage therapists (platform-to-customer), such as Go-Massage on Gojek’s apps, assuming they still provide these services.

4.2 Significance of collaborative governance

It is the time now to turn the discussion downstream to collaborative governance. It is important to note that incumbent business actors in the tourism, hospitality, entertainment, and other sectors have attempted to adapt to new challenges by either strengthening their current business models or adopting new ones, both exclusively or in combination with existing models (Zach et al., 2020). However, the tax administration might fall behind when enterprises move quickly. It is therefore essential to consider the ethical implications and projected multiplier effect of these changes. In addition, it is impossible to halt the development of the digital economy. Instead of maintaining the status quo, the government should support collaborative efforts to adapt to this new business model (Kaplan & Nadler, 2017). Collaborative governance, as part of the governance paradigm, encourages stakeholders to work together to solve challenges (Hafel et al., 2021).

Collaborative governance at the government level can help solve different public issues (Tando et al., 2021). The central government and sub-levels should collaborate to provide shared services or resolve administrative and resource conflicts. This intergovernmental collaboration addresses government affairs that may lead to conflicts of interest. Additionally, the issue of taxation for digital transactions remains a topic for discussion, and collaborative efforts will be necessary not only between the central and local governments but also among local governments.

To ensure legal certainty, fairness among taxpayers, and revenue productivity, it is crucial for the central government to take the lead in initiating central-regional coordination to resolve overlapping taxing rights. Decentralization in Indonesia poses constraints on local governments, despite the potential for them to propose changes in the democratic environment. For taxes under local jurisdiction as per the HKPD Law, a collaborative model between central and local governments is essential. This can involve central collection and allocation of funds to local authorities or exclusively managed by the central government. Without such confirmation, the risk of double non-taxation by both central and local governments is a concern. Therefore, adopting a collaborative paradigm is necessary to promote a fair and productive tax system.

In addition, it is important to consider collaborative governance at the interregional level. Collaboration between various local government levels is regulated under Chapter XVII of Law No. 23 of 2014 on Regional Administration. Due to the inherent cross-regional externalities of this technological innovation, cross-border digital economic disputes across regions are likely to emerge. While the destination principle typically assigns tax collection rights to the region where the final consumption takes place, the HKPD Law adopts a supplier collection method, as seen in the case of entertainment tax, where the authority to impose taxes lies with the local government where the supplier is based. To address potential disputes and ensure a fair distribution of tax revenues, considering a portion for affected buffer zones around the economic activity center is crucial. Interregional cooperation can help tackle these challenges, but the policy set by the central government will wield the most significant influence.

5 Conclusions

This article provides an overview of taxing powers for local governments in the digital economy. Digitally served accommodation, food delivery, and entertainment services face unique challenges and opportunities. By analyzing all documents and studies, the research hypothesis has been confirmed. Moreover, the advent of digital platforms and online marketplaces has complicated the issue of local government taxing power, as they may operate across multiple jurisdictions and blur the lines of traditional tax boundaries. Overlapping taxing powers between central and local governments is possible due to differing interpretations of tax objects or local governments' limited authority and infrastructure. Tax revenue leakage is a potential outcome of increased illegal accommodation services, a surge in underground economic activity in food delivery services, and the difficulties of targeting online entertainment services. These inherent challenges in each digital service type must be addressed to prevent tax revenue loss.

The Indonesian tax regime for hotel, restaurant, and entertainment taxes, collected through supplier/vendor collection, is a critical prospect in the context of international guidelines on cross-border transactions. However, it can be difficult for local governments to enforce tax collection from providers located abroad. Therefore, it would be more practical for the central government to administer the digital service tax. One proposal is to appoint a digital platform provider under the supplier collection regime for accommodation services, food delivery, and premium entertainment. However, ensuring clarity and defining the respective taxing powers of the central and local governments becomes crucial in order to avoid potential conflicts, promote efficient tax administration, and unlock the full potential of digital consumption taxation in these jurisdictions. This may require careful consideration of relevant laws, regulations, and policies, as well as close coordination and cooperation between different levels of government to establish a clear and coherent tax framework for the digital economy.

This research provides a foundation for effective intergovernmental collaboration in digital tax sharing. However, future research should be expanded to include a broad range of stakeholders as key informants. This may include representatives of central and regional policymakers, platform providers and their associations (such as the Indonesian E-Commerce Association), and business actors or merchants engaged in e-commerce with varying turnovers. Comparative studies with other jurisdictions that have already implemented e-consumption taxes are also a potential avenue for future research.

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Appendix:

Table 1: Central and local revenue structure for 2019-2021

Source of Revenue	Rp Trillion		
	2019	2020	2021
I. Central Revenue			
1. Tax Revenue	*1546,1*	*1285,1*	*1547,8*
1.1. Domestic Tax	1505,1	1248,4	1474,1
a. Income Tax	772,3	594,0	696,7
b. VAT and Sales Tax on Luxury Goods	531,6	450,3	551,9
c. Property Tax	21,1	21,0	18,9
d. Excise	172,4	176,3	195,5
e. Other Taxes	7,7	6,8	11,1
1.2. International Trade Tax	41,1	36,7	73,7
a. Import duty	37,5	32,4	39,1
b. Export Tax	3,5	4,3	34,6
2. Non-Tax Revenue	*409,0*	*343,5*	*458,5*
3. Grant	*5,5*	*18,8*	*5,0*
Total	*1,960.63*	*1,647.78*	*1,735.74*
II. Local Revenue			
1. Own-source revenue	*124.51*	*115.13*	*131.80*
1.1. Local taxes	64.82	54.10	67.44
1.2. User charges	8.04	7.15	10.12
1.3. Local-owned enterprise	4.62	4.60	5.38
1.4. Other own-source revenue	47.02	49.26	48.85
2. Fiscal balance transfer	*537.09*	*487.59*	*500.95*
2.1. Shared tax revenue	21.35	23.16	24.85

2.2. Shared natural resources revenue	41.30	33.63	26.96
2.3. General allocation fund	359.53	328.39	336.23
2.4. Specific allocation fund	114.90	102.38	112.90
3. Other legitimate revenue	*179.45*	*176.42*	*158.90*
4. Local financing	*90.86*	*74.87*	*55.77*
Total	*931.93*	*854.03*	*847.43*

Source: Authors' own elaboration, 2022.