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# Comments of the Indonesian Delegation on the Issue Note for Workstream II – Intergovernmental Negotiating Committee on the UN Framework Convention on International Tax Cooperation

We appreciate the opportunity to provide input on the drafting of first early protocol (Protocol I) under the UN Framework Convention on International Tax Cooperation. Below are our responses to the *Issues for the Committee* section as outlined in the Workstream II Issue Note paragraph 23:

**(a) Does section III(a) comprehensively describe current rules for the taxation of services and the reasons behind the call for change? Are there any additional considerations that should be taken into account in the workstream's discussions?**

Section III(a) offers a thorough articulation of the structural constraints encountered by developing countries in asserting taxing rights over cross-border service transactions. In particular, the limitations associated with the application of gross-basis withholding taxes, coupled with the restrictive requirement of physical presence as a nexus standard, have significantly undermined source-based taxation. These conditions disproportionately disadvantage developing countries within the framework of existing bilateral tax treaties, thereby curtailing their capacity for effective revenue mobilization.

Moreover, it is our view that the continued transformation of global business models—marked by digitalization and the growing ability to deliver services remotely—will further diminish the taxing capacity of developing countries. The current frameworks embedded in both the UN Model Conventions and OECD Model Conventions are increasingly misaligned with the fiscal interests of developing economies, especially with respect to the effective taxation of income arising from cross-border service provision.

In light of the aforementioned considerations, we underscore the pressing need to revise the prevailing tax treaty standards applicable to cross-border services. Specifically, the UN-FCITC should prioritize the removal of the physical presence requirement as a condition for source-based taxation. It is imperative that the emerging framework affirms and safeguards the fiscal sovereignty of developing countries by enabling them to assert taxing rights over income generated from economic activities within their territorial jurisdictions.

**(b) What considerations are most important in developing possible new rules for the taxation of services?**

We regard the transition from a physical presence threshold to a Significant Economic Presence (SEP) standard as a critical pillar in designing an effective framework for the taxation of cross-border services under the UN-FCITC. Such a paradigm shift offers a viable and timely response to the erosion of source-based taxing rights, which has been exacerbated by the limitations of current nexus rules. The increasing digitalization of the global economy and the shift toward intangible value creation underscore the diminishing relevance of physical presence, highlighting the necessity of adopting more inclusive and future-oriented nexus criteria.

In addition, value creation has no direct contribution to revenue generation, thus it would be hard to link the appropriate taxing right solely based on the value creation. By this regard, it will be not fair if value creation can be a stand-alone driver to create taxing right on a jurisdiction. Therefore, it would be more appropriate if value creation to be a supporting consideration to determining and calculating significant economic presence.

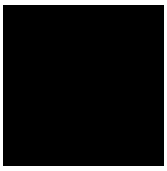
**(c) How can the workstream best define the scope of the protocol in terms of the taxes and services that it will cover?**

We are of the view that the scope of taxes covered in the protocol should be defined based on the economic nature or characteristics of the tax, rather than merely relying on the name or terminology used in each country's domestic tax system. This approach is crucial, considering the significant variation in tax nomenclature and classification across jurisdictions, which often does not reflect substantive economic differences. By prioritizing a substantive approach based on economic characteristics—such as the party bearing the tax burden, the tax base, and its relation to income—the protocol would achieve a more consistent and equitable coverage in an international context.

Furthermore, a definition grounded in economic substance would enhance legal certainty and reduce the risk of tax avoidance practices that exploit differences in terminology (tax arbitrage). In this regard, the protocol may explicitly list the types of taxes considered to fall within the scope of the agreement, providing examples of relevant characteristics, while also allowing for interpretation based on the natural concept of income taxation in cases of uncertainty.

With regard to the types of services to be covered in the Protocol, we are of the view that a clear scope should be established, encompassing various types of services, including technical and managerial services, as well as remote and automated digital services. This is essential to ensure that the provisions of the Protocol can effectively address the diverse forms of cross-border service transactions, which are becoming increasingly complex and rapidly evolving.

Although the possibility of having different rules for different types of services has been discussed, we believe that defining the scope of services in the Protocol should be prioritized in order to avoid interpretive uncertainty in the future.



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