

The Urgency of Obligation To Establish A Legal Entity For Foreign Over-The-Top (OTT) Service In Indonesia

Mohamad Ibadi^{1*}, Sukarmi¹, Patricia Audrey Ruslijanto¹

¹Faculty of Law, Brawijaya University Malang, Indonesia

*Corresponding Author Email: ibadilawyer@gmail.com

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ABSTRACT

This study evaluates the effectiveness and legal urgency of requiring foreign Over-the-Top (OTT) service providers to establish a legal entity in Indonesia. The existing regulatory framework—comprising the Income Tax Law, the Harmonization of Tax Regulations Law, and Circular Letter No. 3/2016—remains limited and has not fully adapted to digital economic realities, particularly the principle of significant economic presence. Using a normative juridical method combined with Economic Analysis of Law, this study finds that foreign OTT operations have created legal uncertainty due to regulatory fragmentation, lack of physical presence requirements, and weak enforceability. Comparative analysis with the U.S. economic nexus model demonstrates the need for Indonesia to shift towards digital presence-based taxation. The study concludes that harmonizing tax, communications, and trade regulations—supported by risk-based and adaptive digital governance—is essential to strengthening fiscal justice, consumer protection, and national digital sovereignty.

Keywords: Legal entity, Foreign OTT, Digital economy, Legal certainty, Economic nexus

1. INTRODUCTION

The development of e-commerce and digital services demonstrates how information technology is transforming human interactions into online transactions without face-to-face contact, a concept similar to the concept of OTT services, which rely on the internet as their primary medium. Similarly, the OTT phenomenon reflects a broader digital transformation, where content distribution and communication no longer rely on traditional infrastructure but instead utilize the internet as their primary medium (Oreku, 2013).

Over-the-Top (OTT) services are a result of digital technology developments that enable the delivery of communication and multimedia content via the internet, without the need to utilize the physical infrastructure of traditional telecommunications service providers. Digital platforms such as Facebook, Google, WhatsApp, YouTube, and Netflix have now become vital components of people's communication and entertainment activities. Beyond this convenience, OTT services offer advantages in terms of flexibility and efficiency. However, on the other hand, legal challenges arise because the presence and operation of foreign OTTs in Indonesia often do not comply with national legal provisions (Khanna et al., 2025).

A GoodStats survey shows that 33% of Indonesians use OTT services daily. This indicates that OTT is no longer a fringe phenomenon, but rather an integral part of the communication fabric

of modern society. Despite the rapid growth of OTT services, unresolved legal issues remain, particularly regarding foreign OTT providers that lack a permanent legal entity in Indonesia. For example, Netflix can continue to provide its services to consumers in Indonesia without establishing a Permanent Legal Entity (PE) or a legal entity, even though national law requires every business operating in Indonesia to have a local legal entity (Farooq & Raju, 2019).

One fundamental legal issue is the lack of a permanent legal presence for foreign OTT operators in Indonesia, despite their substantial business operations within the country. They leverage national infrastructure and profit from the domestic market, yet often lack a legal entity, as required by national law. For example, Netflix can operate in Indonesia without establishing a legal entity, despite its direct impact on the economy and society (Sujata et al., 2015).

In the Indonesian legal system, a legal entity represents an entity subject to rights and obligations (Butt, 2014). Although a legal entity is not a legal subject in the strict sense of a legal entity, this concept is recognized in international tax law as a form of foreign business presence that has fiscal responsibilities in the country where economic activities are conducted. However, the requirement to have a legal entity in Indonesia serves as an entry point into the country's fiscal jurisdiction, allowing for taxation of profits earned by foreign business actors. This is where the urgency of regulations regarding legal entities for OTT operators becomes crucial, so that the state can uphold legal and fiscal sovereignty over cross-border digital businesses (Koch, 2025).

In comparison, local companies like SCTV and Indosiar are subject to national administrative and legal obligations, including taxes, consumer protection, and content oversight by institutions like the Indonesian Broadcasting Commission (KPI). Meanwhile, foreign OTTs are not subject to similar obligations due to their lack of legal presence in Indonesia. This imbalance risks creating an unfair business climate and harming domestic businesses.

The requirement for foreign OTT service providers to establish a Business Entity is stipulated in Circular Letter of the Minister of Communication and Informatics Number 3 of 2016 concerning the Provision of Application and/or Content Services via the Internet (Over the Top) (Koch, 2025). This provision is stated in Article 5.3, which states that OTT providers are required to have legal status in the form of a Permanent Legal Entity. However, the circular's status as soft law makes it not legally binding and does not provide strong legal certainty. This results in existing regulations being unable to hold foreign OTTs accountable for consumer protection, fulfilling tax obligations, and overseeing digital content.

The absence of a legal entity also weakens the state's position in upholding the public interest. The state struggles to collect taxes, limit the spread of negative content, and enforce

intellectual property rights. In comparison, the United States has established legal frameworks such as the Digital Millennium Copyright Act (DMCA), which strengthens the responsibilities of digital businesses, including mechanisms for handling content violations. In addition, the United States operates a combined system of federal and state regulations under the oversight of the Federal Communications Commission (FCC), with an emphasis on digital content regulation, net neutrality, and user privacy (Fahleni et al., 2025).

From a tax perspective, although Indonesia has issued Law Number 2 of 2020 in response to the digital economy, specific regulations regarding taxes on foreign OTT services are still inadequate. It can be said that it still does not specifically regulate the existence of foreign OTT and the obligation to establish a Legal Entity in a rigid manner.

The OECD, as an international organization, has also proposed a new approach to broaden the scope of taxation for digital entities through the Inclusive Framework on BEPS (Base Erosion and Profit Shifting), including the concept of "significant economic presence." Indonesia, as a member of the OECD Inclusive Framework, needs to adjust its regulations to respond to global challenges and ensure that foreign OTT businesses contribute fairly to state revenue.

2. RESEARCH METHODS

This study uses the normative juridical (doctrinal) research method, focusing on the analysis of legal norms regulating foreign OTT obligations. Three approaches are applied:

- 1) Statute Approach examining the Income Tax Law, HPP Law, PMK No. 48/2020, and Circular Letter No. 3/2016;
- 2) Conceptual Approach reviewing legal entity theory, legality principle, economic presence doctrine, and digital sovereignty;
- 3) Comparative Approach comparing Indonesian regulations with the U.S. economic nexus model and OECD BEPS Pillar 1.

Primary materials include statutory texts; secondary materials include journals, books, and legal commentaries; tertiary materials include encyclopedias and legal dictionaries. Legal interpretation techniques consist of grammatical, systematic, and comparative interpretation.

3. RESULTS AND DISCUSSION

Legal and Practical Reasons for the Obligation to Establish a Legal Entity for Foreign OTT Business Actors in Indonesia

The requirement to establish a legal entity for foreign Over-The-Top (OTT) businesses in Indonesia is a logical consequence of the principle of state sovereignty in regulating the jurisdiction of the digital economy that is developing across national borders. In the context of national law, the existence of a legal entity is not only understood as an administrative form of a business entity, but also as an instrument to uphold the principles of legality and legal certainty in the implementation of technology-based economic activities. This principle is based on the view that every business activity that gives rise to legal consequences in Indonesian territory must be subject to the national legal system, including foreign businesses operating virtually through the internet. Thus, the establishment of a legal entity for foreign OTTs is a concrete manifestation of the principle of *lex loci solutionis*, namely the application of law based on the place where the legal consequences of an act or transaction occur (Ramli et al., 2022).

Legally, the basis for the obligation to establish a legal entity for foreign business actors, including OTT, can be traced in several main regulations, namely Law Number 36 of 2008 concerning Income Tax, Law Number 7 of 2021 concerning Harmonization of Tax Regulations (HPP Law), and Regulation of the Minister of Finance Number 48/PMK.03/2020. The provisions in Article 2 paragraph (5) of the Income Tax Law emphasize the concept of a Permanent Establishment (PE) as an entity that carries out business activities in Indonesia, whether through representative offices, branches, factories, warehouses, or digital forms such as computers, servers, or electronic agents. This concept shows that the economic presence of a foreign entity is no longer determined by physical presence, but can also be recognized through a systematic and recurring digital presence. Thus, the government has a legal basis to impose tax obligations on foreign OTT companies that earn income from the Indonesian market, even if they do not have a physical office in the national jurisdiction.

Furthermore, Article 32A of the HPP Law affirms the Minister of Finance's authority to appoint other parties, including electronic system providers, to carry out tax withholding, collection, remittance, and reporting. This provision expands the scope of digital tax subjects and introduces administrative sanctions in the form of access termination for electronic system providers who fail to fulfill their tax obligations. In the context of digital law, this provision not only regulates fiscal aspects but also reflects the strengthening of the concept of economic presence—namely, the recognition of the existence of a cross-jurisdictional digital economy that

has legal implications in Indonesia. Thus, tax obligations are no longer determined solely by physical presence, but by the intensity and continuity of digital economic activities.

On the other hand, the regulation in the Circular Letter of the Minister of Communication and Informatics Number 3 of 2016 concerning the Provision of Application Services and/or Content via the Internet is relevant because it emphasizes the requirement for foreign OTTs to establish a legal entity in Indonesia. Although it is a soft law and does not have direct binding force, this circular reflects the government's policy direction in expanding the meaning of a legal entity in the context of the digital economy. This regulation serves as a normative guideline to fill the legal gap that has not been comprehensively regulated in positive law, particularly regarding legal responsibility and oversight of foreign OTT activities in Indonesia. This provision emphasizes that legal presence is crucial to ensure that any foreign entity profiting from the Indonesian market can be held legally and fiscally accountable in accordance with the principle of national legal sovereignty (Ott, 1971).

From the perspective of legal entity theory, as explained by Molengraaff and reinforced by Tami Rusli, a legal entity is an entity that has independent rights and obligations, is capable of performing legal acts, owns its own assets, and can sue and be sued in court. In the digital context, this principle can be applied to permanent establishments (PEs), which allow for recognition of the economic existence of foreign companies without the need for formal legal entity formation. However, the establishment of a legal entity is still necessary to provide legal certainty, ease of supervision, and protection of national interests and consumers. With a local legal entity, the government can more easily enforce the law in cases of personal data protection violations, the distribution of illegal content, or consumer disputes, because there is a clear legal subject under Indonesian jurisdiction.

In practice, the lack of harmony between tax and telecommunications sector regulations is a major challenge in implementing legal entity obligations for foreign OTTs. The Income Tax Law and the HPP Law emphasize fiscal aspects, while the 2016 Circular Letter of the Ministry of Communication and Information Technology emphasizes the presence of digital laws and oversight. This lack of synchronization has the potential to create legal uncertainty, both for foreign businesses seeking to comply with regulations and for law enforcement officials who must enforce cross-sector regulations. According to Jan M. Otto, legal certainty requires clear, consistent, and uniformly enforceable rules by authorized institutions. In this context, harmonization between regulations is crucial to creating a legal system that is responsive to technological developments and global economic dynamics.

From an economic perspective, establishing a legal entity for foreign OTTs serves several strategic purposes, including creating fiscal fairness, strengthening state oversight of digital economic activities, and preventing Base Erosion and Profit Shifting (BEPS) practices frequently practiced by multinational companies. BEPS occurs when multinational companies shift profits to countries with low tax rates to avoid tax obligations in the countries where their economic activities take place. With the presence of a local legal entity, the Indonesian government can minimize this practice and ensure that foreign OTT companies make a commensurate contribution to state revenue. Furthermore, establishing a legal entity also supports the creation of a level playing field between foreign and local digital businesses, enabling fair, open, and sustainable economic competition.

However, from the perspective of foreign OTT operators, the requirement to establish a legal entity is often viewed as an administrative burden inconsistent with the cross-border and cost-efficient nature of digital business models. Most global OTT companies operate with a remote presence system, without the need for local entities in each country. Regulatory disharmony between countries also raises concerns about the risk of double taxation in the absence of adequate tax avoidance agreements (P3B). Therefore, an adaptive and proportionate regulatory approach is needed, namely by creating legal mechanisms that balance national interests with the global investment climate.

Thus, the requirement for foreign OTTs to establish a legal entity is not merely an administrative mandate, but a national legal strategy in addressing the challenges of the global digital economy. Establishing a legal entity serves as an instrument to uphold the rule of law, guarantee fiscal justice, strengthen consumer protection, and ensure that digital economic activities in Indonesia take place within a transparent, accountable, and equitable legal framework. In the long term, the synergy between the concept of a Permanent Establishment (PE) and a digital legal presence can serve as a foundation for strengthening national law in facing the era of a cross-jurisdictional digital economy, while simultaneously realizing a legal system that is adaptive to global change while remaining rooted in the principle of Indonesian legal sovereignty.

Considering the complex relationship between law, economics, and digital technology, the policy of establishing legal entities for foreign OTT platforms in Indonesia is a concrete manifestation of the state's efforts to uphold legal sovereignty in cyberspace (digital sovereignty). In the era of digital economic globalization, the boundaries of state jurisdiction are increasingly blurred because economic activity is no longer based on physical presence but rather on economic presence. Therefore, an approach that relies solely on the principle of territoriality is no longer

adequate. The obligation for foreign OTT platforms to establish local legal entities represents a reactualization of the principle of legality that adapts to the dynamics of the global digital economy.

This approach aligns with Richard A. Posner's view in the Economic Analysis of Law theory, which argues that law must function as an incentive mechanism to create social efficiency. In this context, law is not merely seen as a repressive instrument, but also as a regulatory tool that encourages rational behavior among economic actors to comply with regulations. When the cost of non-compliance is set higher than the cost of compliance, the law becomes economically efficient. Thus, establishing a legal entity for foreign OTT creates a self-enforcing legal mechanism—where economic actors are encouraged to comply voluntarily for reasons of economic rationality, not simply the threat of criminal sanctions.

Furthermore, from the perspective of law and development theory, strengthening regulations on foreign OTTs through mandatory legal entity formation can be seen as an effort to create a legal structure that supports sustainable digital economic growth. As stated by Prof. Mochtar Kusumaatmadja, law must function as a tool of social engineering. This means that the existence of law must not be merely normative and static, but must be adaptive and responsive to the needs of economic and social development. In the context of OTTs, regulations that provide legal certainty, tax efficiency, and consumer protection actually strengthen the national digital economic ecosystem and encourage equitable innovation (Gazali & Soelistyo, 2022).

From a legal certainty perspective, the concept proposed by Jan M. Otto is highly relevant. Legal certainty is not only about the existence of written regulations, but also about the consistency of their application, the accessibility of legal information, and public trust in the legal system itself. Establishing a legal entity for foreign OTTs creates legal clarity and predictability, allowing all stakeholders—government, businesses, and consumers—to understand their rights and obligations proportionally. This reduces jurisdictional conflicts, strengthens Indonesia's position in international negotiations, and ensures equal legal treatment for local and foreign businesses.

Furthermore, from an administrative efficiency perspective, the existence of a local legal entity facilitates coordination between agencies such as the Ministry of Communication and Information Technology, the Directorate General of Taxes, and the Personal Data Protection Agency in enforcing the law. Without a clear legal entity, cross-border law enforcement requires a complex and expensive mutual legal assistance (MLA) mechanism. With a local legal entity, the government can take direct administrative actions such as blocking, tax enforcement, personal data audits, and copyright enforcement without violating the principle of sovereignty of other countries.

This means that the establishment of a legal entity not only creates economic efficiency but also institutional efficiency in national legal governance (Kim & Kim, 2019).

Furthermore, from an economic justice perspective, this policy also prevents competitive imbalances between local and foreign OTTs. Previously, foreign OTTs like YouTube or Spotify could operate in Indonesia without the same licensing and taxation obligations imposed on local OTTs like Vidio or Mola TV. This created market distortions that potentially weakened the national creative industry. By mandating the formation of a legal entity, all industry players are on a level playing field, ultimately supporting the principle of distributive justice in economic law.

In addition to legal and economic aspects, this policy also has ethical and social implications. In the context of digital broadcasting, OTT platforms wield significant power in shaping public opinion and culture. Therefore, the state has a moral responsibility to ensure that circulating content does not violate moral norms, damage public morals, or give rise to disinformation. By having a legal entity in Indonesia, OTT platforms can be directly monitored and held accountable for violating national laws, as stipulated in the ITE Law, the Copyright Law, and the Personal Data Protection Law.

Ultimately, the policy of establishing legal entities for foreign OTTs in Indonesia is a manifestation of the principle of balanced regulation—that is, a balance between protecting national interests and openness to global investment. From an Economic Analysis of Law perspective, this policy provides significant net social benefits by strengthening tax revenues, reducing law enforcement costs, increasing investor confidence, and protecting consumers from digital risks. Legally, this policy affirms the role of law as an instrument of efficiency and justice; economically, it strengthens Indonesia's competitiveness in the global digital economy; and morally, it ensures that technological progress remains grounded in the principles of social responsibility and the rule of law.

The Effectiveness of Legal Entity Establishment Regulations with the Development of Cross-Border Digital Services

In the context of regulatory effectiveness, one fundamental issue facing Indonesia is the persistent legal paradigm based on territorial sovereignty, while digital economic activity transcends jurisdictional boundaries. Regulations that emphasize physical presence are becoming less relevant when economic activity and value exchange now take place in cyberspace. Within this framework, the principle of significant economic presence is crucial because it captures the essence of cross-border economic activity based on transaction value, user volume, or data obtained from domestic markets, rather than solely the physical location of business entities. This

paradigm shift demands a fundamental shift in the orientation of national law, from merely regulating the formal form of legal entity presence to regulating the substance of digital economic activity that has a real economic impact in Indonesia.

The limited effectiveness of regulations is also exacerbated by overlapping policies across sectors. The taxation, communications, and trade sectors still operate within their own normative frameworks without strong conceptual harmonization. As a result, foreign OTT operators often face dual obligations or even legal vacuums. This lack of synchronization creates legal uncertainty, which, according to Jan M. Otto, can undermine trust in the legal system and lead to high legal transaction costs. In the long term, this situation not only hampers law enforcement but also undermines Indonesia's competitiveness in attracting digital investment, as businesses prefer jurisdictions with clearer and more consistent regulations.

Therefore, the establishment of a legal entity for foreign OTTs should not be understood merely as an administrative instrument, but rather as an integral legal policy strategy in digital economic governance. Effective regulations should be designed based on a cost-benefit analysis, as emphasized by Posner in his theory of Economic Analysis of Law. Regulation is considered efficient if the resulting social benefits outweigh the costs of compliance and enforcement. In this context, foreign OTT regulations will be effective if they create legal certainty, increase state revenue, and protect the public interest without hindering digital innovation. This means that the law should not become a bureaucratic burden that hinders the dynamics of the digital economy, but rather serve as an enabling instrument for sustainable growth.

A comparison with the economic nexus model in the United States provides valuable lessons for Indonesia. The *South Dakota v. Wayfair* (2018) ruling demonstrated that a country can maintain its fiscal sovereignty without requiring a physical presence from digital businesses. The application of thresholds based on revenue and transaction volume demonstrates that taxes can be levied fairly on companies that derive significant economic benefits from the domestic market. This model aligns with the spirit of the OECD/G20 Inclusive Framework on BEPS Pillar 1, which encourages the redistribution of taxation rights based on a company's real economic contribution to the market. By adopting this principle, Indonesia can strengthen its fiscal position while enhancing its legal legitimacy within the international trade framework.

Beyond the economic dimension, regulatory effectiveness is also determined by the application of a strong legality principle. According to Maartje Verhoeven and Rob Widdershoven, the legality principle not only legitimizes government actions but also serves as a basis for limiting authority to prevent arbitrary state action. In the context of foreign OTTs, weak or soft law

regulations, such as the Ministry of Communication and Information Technology Circular Letter No. 3 of 2016, actually raise legitimacy issues because they lack clear binding force. As a result, foreign OTT operators lack a clear legal obligation to submit to Indonesian jurisdiction. Therefore, regulatory upgrading is needed in the future through the creation of laws or government regulations that explicitly regulate the legal presence of foreign digital entities and their legal responsibilities to the state.

Furthermore, foreign OTT regulatory reform should utilize a risk-based regulatory approach that leverages data and technology in the oversight process. This model allows the government to assess the level of risk a digital entity poses to the public interest, such as personal data protection, cybersecurity, or potential tax evasion, and then apply a proportionate level of oversight. Thus, regulations are not uniform and rigid, but rather adapt to the dynamics of technology and the complexities of digital business. Furthermore, a periodic regulatory review mechanism is also needed to ensure each regulation remains relevant to global developments, as implemented by the European Union within the framework of the Digital Services Act (DSA) and the Digital Markets Act (DMA).

From the perspective of legal certainty and economic efficiency, effective regulation of foreign OTTs can only be achieved through cross-sector harmonization and synergy between institutions. Collaboration between the Ministry of Communication and Informatics, the Directorate General of Taxes, the Financial Services Authority, and the Ministry of Trade must be formalized in a regulatory coordination mechanism based on inter-agency governance. Without this mechanism, policies will continue to operate in a partial and fragmented manner. Furthermore, it is necessary to formulate transparent and technology-based compliance framework standards, such as electronic registration, digital reporting, and automated enforcement, to ensure compliance without excessive administrative burden.

Thus, the effectiveness of regulations governing the formation of legal entities for foreign OTTs in Indonesia depends heavily on the country's ability to balance the three main pillars of digital economy law: legal certainty, economic efficiency, and fiscal fairness. Regulations that overemphasize control without regard for efficiency will lead to compliance fatigue, while overly lax regulations will weaken the rule of law and reduce potential state revenues. Therefore, regulatory design is needed that is proportional, based on the principle of legality, adaptive to global developments, and responsive to the needs of the national digital market.

Such regulations not only ensure effectiveness in the formal sense (legal compliance), but also substantive effectiveness - namely the extent to which the regulations are able to create new

socio-economic value, strengthen Indonesia's digital sovereignty, and ensure that the law remains a means of justice and prosperity in an increasingly integrated global economic order.

4. CONCLUSION

Foreign OTT operators must be obligated to establish a legal entity in Indonesia to ensure legal certainty, fiscal justice, and fair competition. Current regulations provide only partial guidance and lack enforcement power. To strengthen regulatory effectiveness, Indonesia must adopt a digital-presence-based legal framework aligned with global standards such as the economic nexus model and OECD BEPS. Cross-sector legal harmonization is essential to achieving national digital sovereignty and ensuring that foreign OTT entities comply with Indonesia's legal and fiscal obligations.

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