PRAKARSA *Policy Brief*

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OMNIBUS LAW ON TAXATION: WINNING OR LOSING?

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Key Points:

- The reduction in the Corporate Income Tax rates (PPh Badan) can be misused by large domestic corporations to avoid taxes through round tripping or "local capital" being rolled back.
- The elimination of Income Tax (PPh) on overseas dividends does not always guarantee repatriation or return of funds parked abroad to the country. The risk of tax avoidance will remain high despite the removal of foreign dividend income tax. Providing discretive sanctions relief undermines the integrity of tax law and distracts the authority from the goal of increasing taxpayer compliance.
- Positioning tax incentive policies as an attraction for foreign investment, especially without adequate transparency and evaluation, can potentially lead to a loss of tax revenue that should have been received (revenue forgone). Tax incentives are not investors' main consideration in placing their investment in a country.

Introduction

The government has submitted the Omnibus Law on Taxation to the House of Representatives (DPR) for discussion and ratification. The public's attention has not been as alert, as compared to the labor provisions within the Law, although the Law on Taxation will have a direct impact on community welfare. At the time of writing this Policy Brief, the discussions on the Omnibus Law on Taxation in the DPR were still unclear, whether it would continue or not.

The government argues that tax relaxation through the Omnibus Law on Taxation is needed to attract foreign investment in Indonesia. However, based on various examples of literature, the biggest obstacle to investment in the country is not tax relaxation, but legal uncertainty, inefficient bureaucracy, and corruption.[1] According to data from the World Bank, which routinely measures the level of ease of doing business in world countries, Indonesia's index in 2020 is a rank of 73 out of 190 countries and it has not changed since the previous year. The country's rank is still far below other Southeast Asian countries such as Singapore (2), Malaysia (12), Thailand (21), Brunei Darussalam (66), and Vietnam (70).[2]

This Policy Brief tries to analyze critically three main issues in the Omnibus Law on Taxation, namely: (1) a reduction in the Corporate Income Tax rates (PPh Badan), (2) elimination of the tax on dividends, and (3) placement of tax incentives in one statute.

Reduction in Corporate Tax Income Rate (PPh Badan)

The Academic Paper of the Omnibus Law on Taxation outlines the main reason for the reduction in PPh Badan, namely to increase competitiveness to attract investment from abroad. This assessment from the government seems to refer to "the global race to the bottom" trend and the report from the Organization for Economic Cooperation and Development (OECD), in which the average rate of PPh Badan globally is 21.4% and in the Southeast Asia region 22.3%. The government has assessed the current tariff as too high and not supportive of domestic businesses.

Although the government acknowledges that tax rate competition can have negative consequences including the risk of the potential loss of tax revenues, it hopes that the reduction in PPh Badan can contribute to the growth of economic activity and have a positive impact on increasing investment. To achieve this, the government will reportedly complement the policy with a variety of approaches, namely:

1. The reduction in PPh Badan will be accompanied by improvements in other factors that support the investment climate;
2. To anticipate a decline in tax revenue in the near future and overall, the government will take measures to improve taxpayer compliance and increase the tax base; and
3. The rate reduction may reduce the taxpayer's intentions to avoid taxes.

On the other hand, in the context of a developing country like Indonesia, there is a fact that investment that is claimed to be "foreign investment" is actually domestic capital that is "round-tripped". After first being sent to tax havens, it is then taken back to Indonesia packaged as "foreign investment" to obtain tax breaks.[3] Looking at the list of the top 20 countries that channel funds as foreign investment to Indonesia, some of them are tax havens, such as Singapore, the Netherlands, the British Virgin Islands and Mauritius. This provides a strong indication of the round tripping phenomenon. Therefore, it becomes important to investigate: for whom is the plan of PPh Badan relaxation intended? Is it to encourage national economic growth or is it to provide incentives to national oligarchs who have been avoiding taxes, diverting their profits to tax havens only to reinvest in the country using the clothes of foreign investors and again to enjoy various tax relief facilities?

Before the plan for the formation of the Omnibus Law on Taxation, even without a reduction in the tax rates, Indonesia's investment performance had been good. Indonesia is too important to be ignored by foreign investors because of the scale of the country's economic activity,[4] which is similar to China and India whose PPh Badan remain at around 25% but still attracts global investors. Also, tax instruments are not really needed to increase competitiveness to attract investment from abroad. In the 2017-2018 Global Competitiveness Report by the World Economic Forum (WEF), five main problems were listed as affecting investment in a country: corruption, complicated bureaucracy, access to finance, infrastructure, policy consistency and political stability. Tax rates and taxation policies occupied the sixth and eighth positions. This means that relaxation and tax incentives are not the highest priority of investors and are not part of the main reasons for choosing an investment area. In a different report on the ease of doing business, Indonesia's rank in 2020 is stagnant at 73, with the worst scores on the indicator being starting a business with an index of 140 and enforcing contracts with 139.[5] However, these facts have been ignored by the government and academic drafters by forcing rate reductions as an instrument to attract investment.[6]

Furthermore, the government has not put much consideration into studies that reveal that only non-essential types of investment, such as portfolio shuffling and 'accounting nonsense', are aggressive and interested in the reduction in PPh Badan.[7] Meanwhile, the types of real investment that create jobs, which build a long-term supply chain network accompanied by transfer of expertise, do not particularly pursue tax relaxation. These real investors will continue investing in Indonesia for the reason that the country is rich in natural resources, has a large population, abundant labor, a large scale of economic activity (member of the G20) and high socio-political stability.

An external factor that shapes the plan to reduce PPh Badan is an objective to strengthen Indonesia's position in the **"tax competition" (race to the bottom)** at the regional and global levels. Tax competition is a tax rate war that is very destructive for the countries involved, especially developing countries with large scales of economies, as opposed to rich countries, which do not rely on state revenues from corporate tax rates.[8] The government is aware of these facts and threats; however, it insists that it can anticipate them by providing some notes and calculations.[9]

According to the government's calculation, the impact of the decrease in the Gross Domestic Income (GDI) due to the lowered PPh Badan in the short term will be paid off and will be exceeded in the long term due to increased investment, employment, and household consumption which will increase economic growth.[10] However, some things are ignored and overlooked in this calculation, one of which is the small proportion of the PPh Badan reduction on the growth of the Gross Domestic Product (GDP) at the macro level. Until now, many studies have shown that there is no significant effect of reducing tax rates on economic growth. The general explanation for this is because the proportion of PPh Badan contributions to the economy as a whole is small compared to the proportion of other sectors.[11] Even as can be seen in the calculation of the Fiscal Policy Agency (BKF) in 2019, the increase in the impact of the lowered PPh Badan on the projected GDP growth in 2030 is only 1.20%.[12]

Table 1. BKF Simulation regarding the Direct Impact of the Reduction in PPh Badan (2019)

Impact	Year					
	2021	2022	2023	2024	2025	2030
GDP Growth	-0,15	0,00	0,41	0,60	0,76	1,20
Revenue Forgone	-87.445	-87.209	-80.447	-89.500	-98.624	-141.447
Net Tax (% thd PDB)	-0,54	-0,44	-0,23	-0,24	-0,24	-0,22

Source: Omnibus Law on Taxation Academi Paper.

Based on this calculation, the reduction in PPh Badan will in fact contribute to the worsening of the problem of inequality and further concentrate or the more concentrated political and economic power among the select few. Profits from corporations generally or mostly end up in the pockets of shareholders and corporate capital owners, which only worsens inequality. This could only be avoided if the PPh Badan reduction policy were covered by a larger tax imposed on the super-rich individuals. However, this would be difficult to impose as the reduction in PPh Badan itself is a reflection of the government's strong support for the super-rich.

Another objective of this income tax reduction is to encourage compliance and reduce taxpayers' intentions to avoid taxes. However, so far, there is no empirical evidence to support the claim that a reduction in the tax rate will have a positive effect on the behavior of taxpayers to be more compliant and stop engaging in tax avoidance practices. The narrowing of the gap in the Indonesian corporate income tax rate with those of other countries especially in Southeast Asia may reduce the practice of profit shifting from Indonesia to other countries or tax havens.[13] However, many believe that the previous government's measure of using anti-tax avoidance instruments is far more effective in controlling and preventing tax avoidance practices than the Taxation policy in the Omnibus Law.[14]

Furthermore, the government claims that a reduction in

PPh Badan will have an impact on the broadening of the tax base, but there is no evidence to support this. What is often used as a strategy in expanding the tax base is increasing the number of taxpayers and preventing tax avoidance practices or adding new tax objects so that the negative impact of the loss of state revenue (revenue forgone) can be controlled. In other words, instead of contributing positively to the widening of the tax base, the policy of lowering PPh Badan is burdening the government with the need to find a replacement to cover it. Ideally, the government should look for or add new sources of tax revenue not as a substitute but instead to complement and expand the existing tax base.

If we reanalyze the existing policies, the current legal facilities are quite attractive to foreign investors. The provisions of the Income Tax Law (UU Pajak Penghasilan) (article 17 paragraph 2b) and the Government Regulation (PP) No.77 / 2017 stipulate that the PPh Badan in the form of a public company can enjoy a 5% reduction in the income tax rate (PPh) by following several requirements.[15] These requirements include at least 40% of shares be traded on the stock exchange and other requirements that encourage companies to "go public", improving corporate governance and transparency which are already very good compared to providing cuts in PPh Badan without these requirements.

Elimination of Domestic and Foreign Income Tax on Dividends (PPh Dividen)

The government argues that the elimination of PPh Dividen imposed within and outside the country is expected to result in repatriation and encourage conglomeration practices, mergers, and the establishment of subsidiaries. The returns from dividends that are reinvested are expected to boost Indonesia's investment climate in the long term. The shift in the Indonesian tax system from *worldwide* to *territorial* basis has so far not been effective in addressing the problem of assets-parking abroad by Indonesians (lockout capital) nor encouraging repatriation or the flow of dividends back to Indonesia. In general, the system shift from worldwide to territorial is a tax reform step that has been taken by the majority of OECD countries.[16] Many studies support the greater benefits of this transformation, in particular, its ability to overcome the weaknesses of the worldwide system which provides great opportunities for tax avoidance practices with the scheme of establishing controlled offshore entities and the practice of parking assets abroad.[17]

The abolition of PPh Dividen imposed abroad does not always guarantee repatriation or the return of funds parked abroad to the country. Britain's failure to pursue a similar policy in 2009 can be instructive.[18] Instead of repatriation, what happened was a 16.7% increase in investment by UK companies in countries with low tax rates. This again underscores the risk of tax avoidance that remains high regardless of a system change. So far, to overcome the weaknesses of the worldwide system, tax authorities, including those in Indonesia, have used anti-tax avoidance instruments such as the Controlled Foreign Company (CFC) rule. By considering the possibility of repatriation failure, the CFC rule instrument must still be put to use.[19]

The elimination of PPh Dividen is very likely to have an impact on *rerouting investment*.[20] However, the type of investment needs to be monitored for 2 (two) reasons: (1) the risk of round tripping reappears with portfolio shuffling and accounting nonsense being very likely to be carried out by foreign dividend holders;[21] (2) the possibility of them placing an investment in the stock market presents a loophole for the funds to be diverted back to other tax havens.

The requirement for a certain obligated period of domestic investment will not have a positive impact if there is no requirement for the investment to be placed in the real sector. The specified period, hence, is prone to failure and will not achieve its true positive goal of contributing to the national economy. One proof of this risk is the failure of the tax amnesty program to hold funds in the country after the three-year period ended because there was no obligation to place the funds in the real sector.[22] If that happens again, it will have an impact on the concentration of wealth among the wealthy few shareholders and worsen the situation of inequality.[23]

Besides, without certain preconditions, if immediately enforced, the domestic investment obligation will have an implication for the release of taxation of assets parked abroad, or in other words, it can be considered as hidden tax amnesty. Therefore, the requirement to invest in the real sector is a form of reciprocity that is relevant to prevent risks, both revenue forgone and the aforementioned risk. The elimination of PPh Dividen imposed abroad also does not necessarily reduce tax avoidance practices conducted through disguising the identity of the beneficial owner. One of the main problems regarding dividend tax is the behavior of shareholders to avoid taxes by deliberately holding profits at the company level and increasing retained earnings. Another problem is the concealment of the beneficial owner's identity either through individuals or other companies (generally in the form of conduits and mailbox companies) in low tax countries.

An exemption from dividend taxes for shareholders and taxation which is only done once at the corporate level will reduce the motivation of the capital owners to hide through a scheme of concealment of the beneficial owner's identity. However, to eliminate this seems impossible. There is always a reason to keep the identity of the beneficial owner hidden for tax avoidance purposes under other schemes.

Placement of Tax Incentives in one Statute and Customs Fines

As stated at the beginning, tax incentives and tax relaxation facilities offered by a country, especially by a developing country, are not the main benefits that investors expect.[24] Therefore, making incentives as a promotion to attract investment without adequate evaluation only harms the state because of the loss of revenue that should be received (revenue forgone) and it encourages the practice of round tripping along with the widespread practice of tax evasion and avoidance.[25] So far, the tax omnibus law has been used as a platform to collect and place various tax incentives and relaxation facilities.

One of the most important things that is not accommodated in the Omnibus Law is that there are no rules that explain the abuses of tax incentive packages for tax avoidance practices. One common pattern of misuse of tax incentives is by utilizing the loss compensation facility which is used for aggressive tax planning. Misuse of tax holiday is also often conducted to design complex corporate structure schemes such as holding company structure to carry out transfer pricing.[26]

Another problem related to providing tax incentives is the government's failure to ensure transparency in providing the incentives. The absence of transparency and subjective assessments of taxpayers who are entitled to receive incentives can become loopholes for abuse of authority. So far, this process has been very covered up, so the public does not know the list of corporate taxpayers or companies that have received the tax incentives. Disclosing information regarding this matter should not be against the rules of confidentiality of taxpayers' information.

Furthermore, besides the existence of several tax incentive regulations, the government has also covertly provided incentives and subsidies in the form of *tax expenditures*.[27] In recent years, the activities of tax expenditures in the form of subsidies and incentives by the Ministry of Finance have been significant.[28] Evaluation should have been carried out to assess the impact of this policy and whether this policy is appropriate to be continued.

Table 2. Ministry of Finance Tax Expenditures, 2016-2018

	2016	2017	2018
Tax Expenditures (Trillion rupiah)	143,6	196,8	221,1
Ratio of Tax Expenditures to GDP	1,16%	1,45%	1,49%

Source: Directorate General of Taxes, Ministry of Finance.

Apart from this, the existence of a low effective tax rate in Indonesia indicates the many incentives that have been enjoyed by corporate taxpayers.[29] Data shows that the average effective tax rate in Indonesia with tax incentives is 11.4%, far from the 25% PPh rate set by the government. The addition of subsidies and incentives will further reduce the existing effective tax rate. Therefore, issuing regulations related to the provisions of incentives and tax relaxation at the statutory level will benefit taxpayers because of the guarantee of legal certainty and policy stability in the long term. This is because so far the regulations on tax incentives and relaxation facilities are prone to changes because they depend on the political condition.

In the Omnibus Law on Taxation, customs fines are set lighter than what is implemented today. On the point of customs, the Ministry of Finance has reduced customs fines from 1000 percent to a maximum of 400 percent. It is expected that the reduction of customs fines will effectively increase taxpayer compliance. However, in theory, apart from requiring the fulfillment of the principles of proportionality, accuracy and necessity, rearranging administrative sanctions to be lighter requires assurances of transparency, justice and certainty for taxpayers. Ensuring that there are actions that are objective, transparent, and wherever possible, eliminate discretion provides more assurance of justice and certainty required by taxpayers.[30]

Reflecting on the massive practices of illicit financial flows, which is a problem for developing countries in optimizing state revenues, it is necessary that export and import transactions between countries are controlled. Therefore, in addition to rationalizing customs fines, improving export-import or customs governance is urgently needed to cover trade balance deficits.

Policy Recommendations

Based on the analysis above, here are several suggested policy recommendations:

- The government does not need to reduce PPh Badan. A reduction in the tax rates could burden the government to find a replacement for the state revenue lost due to this policy. To increase economic growth, the government should focus more on improving the ease of doing business, especially factors related to starting a business, licensing, business contracts, tax reporting, and payment systems for business entities.
- The government needs to review the policy plan for the elimination of PPh Dividen imposed within and outside the country. The abolition of PPh Dividen imposed abroad does not always guarantee repatriation. The requirement for investments to have certain obligated time periods in the country will not have a positive impact on national economic growth if there are no requirements for the mandatory investment placement in the real sector. In addition, if it is immediately enforced, it will have an implication for the release of taxation of assets parked abroad.
- The government must increase the transparency in the provision of tax incentives that prioritizes the principle of transparency itself, including issuing regulations regarding the provisions of incentive facilities and tax relaxation at the statutory level. Also, the government must conduct a comprehensive study related to the correlation of tax-intensive provision with the level of incoming investment.

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