

TAX AUDITS IN INDONESIA – GROWING THE TAX BASE

**Paper prepared for PhD Presentations, Australasian Tax Teachers Association
Conference, Monash University, 17th-19th January 2018**

Jim McMillan

PhD Candidate at the University of South Australia Law School

17 January 2018

Keywords

Indonesia, tax administration, tax audits, tax reform, Directorate General of Taxation (DGT)

Abstract

Indonesia is not only one of Australia's nearest neighbours – it is also one of the world's fastest growing economies. Already the world's 8th largest economy, by 2030 it will be the 5th largest and by 2050 the 4th largest (according to a recent PwC study).

Indonesia has many challenges including, in particular, an inability to mobilise tax revenue to fund Government infrastructure projects and social development programs. In 2016, Indonesia's revenue to GDP ratio was 10.1%, compared with Indonesian President Widodo's short-term target of a 15% tax to GDP ratio and also the better revenue mobilisation performance of Indonesia's South-East Asian neighbours.

This paper examines the interaction between Indonesia's tax collection performance and the design and operation of its tax compliance system. In particular, the paper identifies some of the peculiar features of Indonesia's tax compliance approach, and considers past recommendations made by the OECD, World Bank and IMF, to improve tax collection efficiency, which have not yet been adopted by the Indonesian Government.

The paper also addresses aspects of tax compliance theory, and the distortionary impact of Indonesian tax compliance approaches when viewed in the context of the theoretical model.

Effective tax collection and enforcement strategies have a direct impact on a country's capacity to generate revenue to fund its economic development, and the paper includes observations about how small changes in the tax compliance approach may be able to effect major changes in outcomes.

1. Introduction

Indonesia is one of the world's fastest growing economies. Already the world's 8th largest economy, by 2030 it will be the 5th largest and by 2050 the 4th largest (according to a 2017 report by global accounting firm PwC).

Indonesia has many challenges including, in particular, an inability to mobilise tax revenue to fund Government infrastructure projects and social development programs (OECD, 2016, p. 14). In 2016, Indonesia's revenue to GDP ratio was 10.1%, compared with Indonesian President Widodo's short-term target of a 15% tax to GDP ratio and also the better revenue mobilisation performance of Indonesia's South-East Asian neighbours.

This paper examines the interaction between Indonesia's tax collection performance and the design and operation of its tax compliance system. In the past decade, a number of prestigious international economic agencies (IMF, World Bank and OECD) have noted deficiencies in Indonesia's approach to tax administration. The DGT is the primary revenue collection agency in Indonesia, and Indonesia faces serious challenges in generating sufficient revenue to fund poverty relief and infrastructure development (IMF, 2011, p. 30). The paper considers various aspects of Indonesia's tax compliance approach, as well as recommendations made by the OECD, World Bank and IMF, to improve tax collection efficiency, which have not yet been adopted by the Indonesian Government. The paper also considers how improved co-operation between the Indonesian Supreme Audit Board (Badan Pemeriksa Keuangan, "BPK") and the tax authority (The Directorate General of Taxation, "DGT") could influence moves to improve tax audit effectiveness.

The paper also considers tax compliance theory, and concludes that there is an adverse distortionary impact from current Indonesian tax compliance approaches, when viewed in the context of the theoretical model.

Achieving high tax compliance levels is important. Tax compliance has a significant and direct impact on a country's capacity to generate revenue to fund its economic development, and the research considers how changes in the Indonesian tax compliance approach may be able to effect major changes in revenue collection outcomes.

2. Indonesia's tax collection performance

To measure a country's tax performance in comparison with its peers, reliance is usually placed on the ratio of tax collection as a share of gross domestic product (Le et al, 2008). On this measure, expressed in percentage terms, Indonesia compares poorly with OECD countries, i.e. Indonesia achieved tax collections of 12.6% of GDP in 2011, compared to the OECD average of 33.8% of GDP (Arnold 2012, p.5). Other sources indicate that since 2011, Indonesia's tax to GDP collection ratio has declined further eg, to 10.8% in 2014 (OECD, 2016; Indonesia Investments, 2015) and only 10.1% in 2016 (DBS Group, 2016). This compares unfavourably with tax collection performance in 2014 by other South-East Asian countries, such as Thailand (17%), Malaysia (15.5%), Philippines (14.4%), Singapore (14.2%), and Vietnam (13.8%) (Indonesia Investments, 2015).

The Indonesian Government is aware of its revenue collection challenges and Indonesia's President Joko Widodo has been reported to have set a tax collection target equivalent to 15% of GDP for coming years (Jakarta Post, 18 January 2017). Based on current tax rates, Indonesia's tax system has a theoretical capacity to generate revenue at around 28% of GDP (Fenochietto and Pessino, 2013).

These issues are reflected in the difficulty Indonesia experiences in meeting revenue targets set in the State Budget. For example, in 2015 the Government collected tax revenue of IDR 1,055.6 trillion (approximately A\$110 billion) which was only 82% of its target (Indonesia Investments, December 2016). The problem has been repeated in the 2016 year with tax revenue collections of IDR 1,105.2 trillion (approx. AUD \$115 billion), only 81.6 percent of the target set in the Revised 2016 State Budget (Indonesia Investments, January 2017). It should also be noted that the 2016 year tax collections included a "one-off" contribution of IDR 107 trillion (nearly 10% of total tax collections) from the Indonesian Government's tax amnesty program. Recent media reports note observations made by the Indonesian Finance Minister Ibu Sri Muliani that the performance against revised budget targets improved in the 2017 year, with 91% of the target revenue collected (Indonesia Investments, 2 January 2018); nevertheless, this achievement represents minimal revenue growth compared with the 2017 performance, with tax collections totalling IDR 1.115 trillion in 2017 (Jakarta Post, 9 January 2018).

These are not isolated situations and Indonesia has regularly failed to meet tax revenue collection targets over the past decade. For example, it has been reported that during this period, Indonesia has only twice managed to achieve its annual tax revenue collection target (Indonesia Investments, 2015). Another recent press report (Jakarta Post, 9 January 2018) indicates that the problem is likely to recur in 2018, noting that "if the 2018 tax revenue target is calculated based on the realization of last year's target, which was at Rp 1.15 quadrillion, while the tax office is assigned to collect Rp 1.62 quadrillion, this year's target will see a growth of 23.71 percent".

To address these deficiencies, the IMF and OECD have made specific recommendations that the DGT adopt reforms including improved information gathering powers, use of third-party information, a broadening of tax audit targeting and, in particular, that the DGT should end the practice of mandatory audits of tax refund cases, to allow tax audit resources to be allocated more efficiently and achieve a better revenue collection outcome (Brondolo, 2008 p.52; Arnold, 2012, pp, 30, 38-39; see also World Bank, 2013, p.47; OECD, 2016, p.25). However, these recommendations have not yet been adopted, although an Indonesian Press report in early 2017 (Jakarta Post, 18 January 2017) reported that further reforms of Indonesian tax laws are currently proposed by the Indonesian President, Mr Joko Widodo, and the proposed reforms will include some enhancement of powers available to tax authorities "to access data from other government institutions and other bodies, including banks". The same report also states that a new tax agency may be established to replace the DGT, which would have some degree of autonomy from the Ministry of Finance.

The paper focusses on the legal requirement for mandatory audits of refund cases, and considers a hypothesis that this results (in practice) in audit probability for compliant taxpayers being significantly greater than that for non-compliant taxpayers. The research considers how this distortion could affect overall levels of tax compliance and its consequential impact on revenue collections in Indonesia.

3. Tax Compliance Theory

There is a substantial body of literature concerning tax compliance theory and design of tax compliance systems. Devos, (2014) identifies two streams of theoretical approaches to tax compliance: the ‘economic deterrence model’ and a wider ‘behavioural approach’ which “incorporates both social and fiscal psychological approaches” (p. 14). Bardsley, (1994) has also noted the diversity of academic interest in theories of tax compliance, expanding beyond the field of economics to include “lawyers, accountants, psychologists, statisticians, sociologists, anthropologists and political scientists” (p. 272).

The role of tax audits and the impact of audit probability on taxpayer compliance have been considered by numerous scholars: Devos, (2007 and 2014); Etienne, (2013); Bardsley, (1994); and Rablen, (2014), have all noted the impact of tax audit activity by tax authorities on overall levels of tax compliance, with varying degrees of emphasis. Rablen, (2014) deals specifically with links between audit effectiveness and audit probability in achieving compliance effects.

Within this theoretical context, this paper examines the impact of distortions in tax audit case selection and methodologies on the effectiveness of a tax compliance system, by reference to the experience of Indonesia, and also examines links between those distortions and the capacity of the Indonesian tax system to generate sufficient revenue to meet the Indonesian Government’s expenditure needs.

The hypothesis that this paper contemplates is that through a combination of human resource constraints within the DGT, an intensive tax audit methodology that is generally applied in the conduct of tax audits, and the legal requirement that all tax refund cases must be audited, the practical effect is that only already compliant taxpayers are likely to be subject to tax audit. In turn, in applying tax compliance theory, there is likely to be a very low audit probability for Indonesian entities that should be paying tax but elect to be non-compliant, and this may then be reflected in Indonesia’s low tax to GDP ratio ie, on the basis that the way the tax compliance system operates in practice provides businesses with a significant incentive to be non-compliant. Other existing taxpayers which are only partly compliant can also avoid audit scrutiny by manipulating their tax compliance management to avoid seeking tax refunds, and also benefit from the very low probability that their tax affairs will be subject to DGT audit. Further testing of these hypotheses will necessitate a detailed study of existing Indonesian tax audit processes at a practical level, in order to allow for identification of more efficient and effective ways in which to conduct those activities and achieve better revenue collection outcomes.

4. Review of Tax Compliance Literature in the Indonesian context

Notwithstanding the relatively limited extent of the literature about the Indonesian Tax Compliance System (Korte, 2013, p. 10), a number of inter-connected themes emerge from a review of that literature, which are relevant to the implementation of further tax administration reform and establish a basis for the further research that is the subject of this paper.

A general issue has been identified concerning high levels of deliberate non-compliance and high levels of tax evasion. This is reflected in Indonesia's generally poor performance in collecting tax revenues, leading to declining tax to GDP ratios and continued failure to achieve revenue targets. Rosid et al (2017), Widihartanto (2014), Korte (2013)

The literature includes some analysis of issues caused by Indonesia's low number of registered taxpayers, although the impact of this factor needs to be assessed carefully given Indonesia's high levels of informality in the economy and the high proportion of the population that does not earn taxable income at levels that exceed tax paying thresholds, and also the high cost of collecting revenue from these informal and lower-income taxpayer segments. Caution is also needed in assessing the impact of increasing the number of registered taxpayers in isolation, if in fact this has little impact on achieving increased revenue collections, such as with employed taxpayers whose income is predominantly subject to tax withholding at source. Ikshan et al (2005), Korte (2013).

Achieving a compliance oriented tax culture in Indonesia and improving levels of voluntary compliance have also been considered. It appears from the literature that there is a low level of taxpayer morality in Indonesia and an absence of any general sense of community obligation in favour of paying tax, which leads to negative perceptions of taxation generally in Indonesian society. Whilst there are some indications that steps are being taken to address this issue through improved taxpayer education, there is a general acknowledgement that voluntary compliance levels are very low. Damayanti (2012), Mukhlis (2016), Rosid et al (2017), Huda and Hernoko (2017), Korte (2013). There is a strong focus in the literature on the impact of corruption within the DGT, and Indonesian society and bureaucracy generally, which is reflected in poor taxpayer morale and resulting low levels of voluntary compliance. Prastowo (2017), Rosid et al (2017), Widihartanto (2014), Korte (2013)

The literature also indicates that cultural influences within the DGT itself have a negative impact on Indonesia's capacity to implement effective tax administrative reform, reflected in a general reluctance to embrace change. This is also impacted by the DGT's adoption of a "target system" in which performance measurement of DGT officers is heavily based on achieving revenue targets. Wihantoro et al (2015), Widihartanto (2014), Korte (2013)

There are some indications from the literature that the legitimacy of past tax administration reform processes has been enhanced by international agency involvement (eg, from the IMF), but Widihartanto (2014), in particular, expresses caution about policy-transfer barriers within the DGT and a general mistrust of adopting "foreign" practices. Wihantoro et al (2015), Widihartanto (2014), Korte (2013)

The literature is generally critical of Indonesia's failure to adopt appropriate risk management strategies in implementing its tax compliance activities. There are issues around the heavy emphasis on conducting mandatory audits in tax refund cases, the failure to adopt risk based auditing methods, and generally inefficiency in allocating audit resources. Sari (2016), Hamilton Hart and Schulze (2017), Widihartanto (2014), Korte (2013). There are mixed views on the impact of Tax Amnesty programs and other base broadening activities conducted by the DGT. Hamilton-Harte and Schulze (2017), Korte (2013)

The literature also supports a conclusion that the DGT's adoption of better human resources management practices, improved staff recruitment strategies, and improvements to DGT business system processes, have all been successful. However Korte (2013), in particular, noted that the DGT falls well below international benchmarks for the overall number of tax officers relative to the general population size, and also noted the DGT has a proportionately low allocation of available staff to perform audit functions. Prastowo (2017), Prasetyo

(2017), Susila (2014), Korte (2013). The significance of improving co-ordination by the DGT with other government agencies, especially the anti-corruption commission (KPK), has also been noted. Prastowo (2017). There is also a heavy reliance on corporate income tax collections, reflecting a generalised view that it is easier to extract money from a handful of larger taxpayers. Widihartanto (2014). The poor quality of DGT information technology and issues with accessing taxpayer data, including from third parties, is also a significant factor impacting on the DGT's ability to effectively administer the system. Susila (2014), Korte (2013).

There has also been some consideration of the impact of high compliance costs, and resulting difficulty of achieving full compliance, even for those taxpayers who are voluntarily willing to comply. Susila (2014), Korte (2013).

Conclusions arising from the literature review

As is evident from the review of the literature about Indonesian approaches to tax compliance described above, attempts have been made in the Indonesian context to incorporate elements of fiscal and social psychology models into developing an Indonesian tax compliance framework. However it also appears from the review of the Indonesian-focussed tax compliance literature that these attempts have been patchy and intermittent, with mixed levels of success, and that a focus on the economic deterrence model described by Devos (2014) remains the corner-stone of the Indonesian tax compliance approach, together with an emphasis on tax audits as a means of generating direct revenue (e.g. the target-driven system described by Widihartanto (2014), p.204).

Given the extent of Indonesia's reliance on economic deterrence in the apparent design of the its tax compliance system, it follows that any deficiencies in the implementation of the economic deterrence model assume greater significance. The central hypothesis to be explored in further research is that Indonesia's poor tax revenue mobilisation performance might be attributable to specific features of its current tax compliance approach and, in particular, whether available audit resources are deployed effectively, in Indonesia's pursuit of economic deterrence measures as the central feature of its tax compliance approach.

From the tax compliance literature, in particular Devos (2014), McKerchar (2001), McKerchar et al (2013), it is evident that a number of features are important in improving tax compliance, including improvements to tax morale, taxpayer education and overall levels of tax knowledge, as well as reducing complexity, but that there is no "one size fits all" approach that governs tax compliance theory. From the Indonesian literature, it appears that these issues are at least acknowledged in an Indonesian context, with some progress towards improving the effectiveness of the tax system being made, with improvements in DGT human resources practices and business systems noted by Korte (2013) in particular. However, from the literature it is evident that levels of voluntary compliance remain low, taxpayer morale remains low, and corruption is endemic within the system (reflecting low levels of integrity in the Indonesian tax system).

A comparison with the Australian experience is revealing, and of particular relevance are observations made by Wickerson (1994) and Braithwaite, J. & Wirth (2001) about the importance of adopting appropriate risk based tax auditing methods, as a pillar of the Australian Taxation Office's (ATO) approach to designing the tax compliance system in Australia. Wickerson (1994) identified the importance of better risk management and better targeting of compliance resources at taxpayers (and taxpayer segments) which present the greatest risks. In similar vein, Braithwaite, J. & Wirth (2001) described how the ATO had developed strategies to address these challenges, by developing a more diverse range of tax

compliance products and moving away from a “full audit” approach. In contrast, it appears that this remains an issue in the Indonesian context. To varying degrees, Sari (2016), Hamilton Hart and Schulze (2017), Widihartanto (2014), Korte (2013) have all noted the DGT’s heavy emphasis on conducting mandatory audits in tax refund cases, its failure to adopt risk based auditing methods, and its general inefficiency in allocating audit resources. This aligns with observations made by IMF (2015), about the importance of audit activity as a key deterrent in promoting compliance and that audit effectiveness is enhanced when it is risk-based.

In this sense, the review of the literature confirms the relevance of further research about how the Indonesian tax audit system works in a practical sense. It is noteworthy from the review of the tax compliance literature that there is little by way of detailed analysis of how tax audit systems actually work in a practical setting, presumably reflecting a difficulty in undertaking research about how tax audit activities are conducted. To that extent, research about how the DGT conducts its tax audit activity will enhance the existing literature, both in the general context of tax compliance theory, as well as in the specific context of the Indonesian tax system.

5. Indonesian Tax Law: Audit Requirements

Under Articles 17, 17A and 17B of the *General Provisions and Taxation Procedure Law No. 6 of 1983*, which provide for a refund of a tax overpayment in certain circumstances, it is a pre-condition for making the refund that the Director General of Taxation conducts an audit.

The position under this law is reinforced by Regulations governing tax audit activity, such as Regulation PMK-17 dated 7 January 2013 (and effective from 1 February 2013), which reinforces that a tax audit is mandatory in tax refund cases, as well as setting out in general terms the processes that must be followed in undertaking tax audit activity.

The DGT is authorised to perform tax audits by Article 29 of the *General Provisions and Tax Procedures Law*. The two main purposes of tax audits are to test taxpayer compliance and “other purpose in the context of implementing the provision of taxation legislation” (Article 29.1). Tax audits must be performed within 5 years after the end of a tax period (Article 13). Article 31 allows tax audit procedures to be determined by Regulations made by the Minister of Finance.

Accordingly, the Minister of Finance has issued a regulation (PMK-17) dated 7 January 2013, which sets out tax audit procedures that must be followed by the DGT. PMK-17 confirms that tax audits are “mandatory” where taxpayers seek refunds and “routine” in a number of other circumstances, including where tax overpayments are made (but a refund is not sought), a tax loss is reported, asset revaluations take place, taxpayers have failed to lodge a tax return (or lodged late), and other cases where taxpayers “have been selected for a tax audit based on a risk analysis”. The regulation also sets out various procedural obligations relating to the conduct of tax audits eg, meetings with taxpayers, and time frame for completing (4 to 6 months for examination, and a further 2 months for discussion). (TaxPrime, 2014).

It does not appear that the Regulations specify in detail the actual steps and procedures involved in undertaking audit activity, but do address the formalities involved in conducting audits eg, notification of audit, audit findings letters, meeting schedules, timetables for

activity etc. Further research about how audits are conducted in practice is therefore contemplated.

6. Improving Tax Administration Efficiency: Recommendations of International Agencies

The International Monetary Fund has observed that: “Indonesia faces the challenge of mobilizing revenue to provide fiscal space for poverty relief and infrastructure improvement. However, simply increasing revenue by further taxing compliant taxpayers can cause distortions and increase inequalities. Raising revenues in an increasingly globalized economy requires strengthening broad-based taxes and improving tax compliance.” (IMF, 2011, p.30)

The OECD has noted that: “A number of challenges remain for tax administration, as evidenced first and foremost by Indonesia’s low tax take despite a tax policy design that is broadly reasonable and not as far from international best practice as the low level of revenues might suggest.” (OECD, 2012, p.27)

In the particular context of this paper, significantly, the OECD has observed that: “Although they are not the only tool to improve tax compliance, tax audits constitute an integral part of any tax system based on self-assessment. Given that the tax administration has *limited resources to conduct tax audits, these should be allocated in a way to maximise expected revenue collection. This implies a risk-based audit procedure, sparing taxpayers with a good compliance record, whilst focussing on those where there is evidence of non-compliance,* [emphasis added] possibly on the basis of earlier non-compliance or external data sources. Although tax audits in Indonesia have become more risk-focussed, the DGT still has to commit valuable resources to automatically triggered tax audits of taxpayers with a low risk profile. Any tax return showing an overpayment of tax and including a refund claim is subject to a compulsory tax audit, for example.” (OECD, 2012, pp. 38 & 39)

Two specific reform recommendations made by the OECD should be noted: “Allocate more tax audits on the basis of risk assessments, and eliminate automatic audit requirements, increase the number of government auditors”; and “Make better use of third-party information and indirect ways of assessing tax liabilities eg, by using information on assets or consumption items to trigger tax audits even for those not registered as taxpayers.” (OECD, 2012, p.30).

Improvements to the Indonesian taxation system as a result of Indonesian legislative reforms implemented in 2007 and 2008 have been noted by the World Bank, especially the increase in “the number of registered taxpayers, from a total of about 4.8 million in 2006 to more than 22 million by 2013”. The World Bank went on to observe: “However, the increase in the number of registered taxpayers, who are mostly individuals and small business, has not resulted in a significant increase in revenues, as substantial coverage gaps and systematic administrative weaknesses remain”. (World Bank, 2013, p.47).

Notwithstanding these recommendations, changes to the current Indonesian approach to tax audit activity have not been made. However, there is cause for some optimism that changes may be imminent, especially arising from the tax administration review currently being undertaken by the Ministry of Finance and the DGT (Jakarta Post, 18 January 2017).

Another significant recent development was the issue on 8 May 2017 of Government Regulation in Lieu of Law No.1/2017, which grants significantly improved access powers to the DGT, to allow it to obtain access to financial information about taxpayers from banks, for

the purposes of a tax audit or a tax crimes investigation. In effect, the Regulation eliminates bank secrecy obligations (under banking law) in respect of information requests from the DGT. A previous attempt to include such a measure in the *General Provisions and Taxation Procedure Law No. 6 of 1983 (as amended)* was not successful, and the new Regulation goes some way towards addressing the OECD's 2012 recommendation ie, by allowing the DGT better access to third party information.

Paragraph b of the Preamble to this Regulation states that it has been made because: "Indonesia has entered into an international tax treaty taxation which requires Indonesia to meet the commitment to participate in the implementation of the Automatic Exchange of Financial Account". This is noteworthy, as it highlights how compliance with international tax treaty obligations can be used domestically to achieve needed tax law reforms, without going through the legislative process.

7. External review of DGT – the role of BPK and comparison with ATO experience

Chapter VIIIA of the *Constitution of the Republic of Indonesia* was introduced by the Third Amendment of the Constitution in 2001. By Article 23E of Chapter VIIIA, BPK is established as a Constitutional Agency which is "free and independent" and with "representation in every province" (Article 23G). BPK shares the same legal status as the other Constitutionally established institutions of the Republic of Indonesia i.e. the Presidency, the Legislature (House of Representatives), the Supreme Court and the Constitutional Court. Whilst the members of the BPK board are elected by the Members of the House of Representatives (Article 23F of the *Constitution*), BPK itself is independent. As noted in the most recent Peer Review of BPK, "The legal framework gives the BPK a strong position within the hierarchy of state authorities of Indonesia and can be compared to similar arrangements in many other democratic countries". (Supreme Audit Office of Poland, 2014, p. 3).

Further research on the nature and scope of BPK's performance audit activity of the DGT is contemplated. In this regard it is noted that Australia's Supreme Audit Institution, the Australian National Audit Office ("ANAO"), regularly undertakes performance based audits of Australia's principal revenue collection agency, the Australian Taxation Office ("ATO"). (The ANAO's functions encompass the role of the Auditor-General (an independent officer of the Australian Parliament) and are established, principally, under the *Auditor General Act 1997*.) For example, ANAO's 2017-2018 work program (accessible at <https://www.anao.gov.au/work-program/search?query=ATO>) notes that a current review of "Costs and benefits of the Reinventing the ATO program" is in progress, whilst further reviews are being considered of "Unscheduled taxation system outages" and "Aggressive tax planning". Prima facie, these are indications that external reviews of significant operational and performance issues affecting the ATO are undertaken in Australia. Further research is necessary to examine the comparative effectiveness of these external review function of the ATO's performance in the Australian context, with the effectiveness of BPK's role in connection with the Indonesian DGT.

8. Conclusions and Further Research

This paper has highlighted a number of features about Indonesia's tax system and the function and performance of the DGT as its principal custodian.

First, Indonesia's tax mobilisation effort (expressed as a percentage of GDP) has been declining in recent years, and in 2016 fell to 10.1%, which is weak compared to other international benchmarks. Moreover, Indonesia regularly fails to meet Budget targets, with an achievement of 81.6% in 2016 and 91% in 2017 being the most recent examples.

Second, whilst there have been significant improvements in Indonesia's tax administration since the legislative reform process of 2007 and 2008, the international economic agencies have all noted further scope for improvement, with better targeting of compliance activity and removal of the mandatory audit requirement in tax refund cases a notable example of a reform recommendation that has not yet been implemented.

Third, reform is ongoing. The tax administration reform project announced in January 2017 has a critically important role to play. Early signs are encouraging, in particular, the improved access to banking and financial information recently granted to the DGT (in July 2017).

This paper has also noted the potential role of the BPK. It appears that in recent years tensions between DGT and BPK have been addressed and BPK is actively engaged with performance based reviews of the DGT. Further research about both the nature and scope of those reviews, and measures taken towards implementation of any recommended improvements, is required, in particular, to draw comparisons between the Indonesian and Australian experiences of review activities of taxation authorities undertaken by the respective Supreme Audit Institutions (ie, BPK and ANAO) in those countries. However, as a Constitutionally established institution of the Republic of Indonesia, BPK potentially has a major role to play in identifying and advocating for improved efficiency measures for all Indonesian government agencies, including the DGT. Improvements to tax audit processes should be a high priority.

Fundamentally, the prime difficulty caused by the current Indonesian tax audit approach and the DGT's focus on compliance with the mandatory audit requirement stipulated by the Indonesian tax law and Ministry of Finance regulations, is the result that (apparently) there is a low risk of audit in other circumstances (as articulated in the OECD's 2012 report, highlighted above). Viewed from a tax compliance theory perspective, where risk of detection through compliance activity is minimal, it is likely that this will significantly impact on overall compliance levels, and it is reasonable to assume that this is a factor in Indonesia's poor tax collection performance. Further research about the reasons why current and traditional tax compliance approaches continue to be adopted is therefore warranted.

If it is accepted that the process of legislative change is difficult under the Indonesian parliamentary system, and that the mandatory audit requirement under the tax law cannot be readily changed legislatively, it is arguable that a different focus on tax administrative reform is required. In this regard it is noted that the manner in which tax audit activity is conducted can be regulated by Ministry of Finance regulation, and perhaps a future focus should be on identifying audit methodologies that are less time and resource intensive, to allow for more audit focus on non-compliant taxpayers and expand audit activity beyond tax refund cases. An improved risk of detection and more efficient use of available audit resources could potentially play a significant role in improving Indonesia's tax mobilisation efforts.

Accordingly, it is suggested that further research about the way in which tax audit activities are conducted at a practical level should be undertaken, as well as a consideration of tax audit approaches undertaken in other jurisdictions (eg, Australia), to enable any redesign of current audit approaches to meet both legal obligations (ie, the legislative requirement under Indonesian law for mandatory audit of tax refund cases) whilst also addressing the

international economic agencies' recommendations about improving scope, coverage and efficiency of tax audit activity.

In this regard, the lessons that can be learned from past tax administration reform efforts should also be considered. A study of the failure of the DGT to successfully implement a "High Wealth Individuals" unit (Widihartanto, July 2014) to improve tax compliance is especially noteworthy. The study highlights entrenched practices in the DGT, including punishment of officers for failure to reach tax revenue targets, as disincentives to achieving reform.

Achieving better revenue performance outcomes is a high priority for the Indonesian Government, and further reform of tax audit practices could have a major impact on achieving its revenue targets.

References

- Allan, CM. 1971. *"The Theory of Taxation"*. Penguin. Harmondsworth, UK.
- Arnold, J. 2012. *"Improving the Tax System in Indonesia"*. 30 October 2012. OECD, Paris
- Braithwaite, J. and Wirth, A. 2001. *"Towards a Framework for Large Business Tax Compliance"*. Working Paper No. 24. November 2001. The Australian National University and Australian Taxation Office. Centre for Tax System Integrity. Canberra ACT.
- Brondolo, J., Silvani, C., Le Borgne, E. and Bosch, F., 2008. *"Tax Administration Reform and Fiscal Adjustment: The Case of Indonesia (2001-07)"*. IMF Working paper WP/08/129, International Monetary Fund, Washington
- Damayanti, T.W. 2012. *"Changes on Indonesia Tax Culture, Is there a Way? Studies through Theory of Planned Behaviour"*. Researchers World, Oct 2012, Vol.3(4), pp.8-15.
- Devos, K. 2007. *"Measuring and Analysing Deterrence in Taxpayer Compliance research"*. (2007) 10(2) Journal of Australian Taxation 182.
- Devos, K. 2014. *"Factors Influencing Individual Taxpayer Compliance Behaviour"*. Springer Science+Business Media, Dordrecht.
- Etienne, J. 2011. *"Compliance Theory: A Goal Framing Approach"*. Law & Policy, Vol. 33, No. 3, July 2011. Pp 305-333
- Fenochietto, R. and Pessino, C. 2013. *"Understanding Countries' Tax Effort"*. International Monetary Fund. (working paper: WP/13/244)
- Hamilton-Hart, N., Schulze, G.G. 2017. *"Taxing Times in Indonesia: The Challenge of Restoring Competitiveness and the Search for Fiscal Space."* Bulletin of Indonesian Economic Studies, 52:3, 265-295. Accessed at: <http://dx.doi.org/10.1080/00074918.2016.1249263> (Accessed 28 August 2017)
- Huda, M.K., Hernoko, A.Y. 2017. *"Tax Amnesties in Indonesia and Other Countries"*. Asian Social Sciences; Vol. 13, No. 7; 2017
- Ikshan, M., Trialdi, L., and Syahril, S. 2005. *"Indonesia's new tax reform: Potential and direction"*. Journal of Asian Economics 16 (2005) 1029-1046
- International Monetary Fund. 2011. *"Indonesia: Selected Issues"*. IMF Country Report No 11/310. October 2011.
- Korte, N. 2013. *"The Political Economy of Public Administration Reforms in Southeast Asia: A Comparative Analysis of the Tax Administration in Indonesia and the Philippines."* PhD Thesis, University of Hamburg, Germany. Unpublished.

Le, T.M., Moreno-Dodson, B., and Rojchaichaninthorn, J. 2008. *“Expanding Taxable Capacity and Reaching Revenue Potential: Cross-Country Analysis.”* The World Bank. Poverty Reduction and Economic Management Network. March 2008. Washington, D.C.

Lindsey, T. (Ed). 2008. *“Indonesia: Law and Society”*. 2nd edition. The Federation Press. Leichardt, NSW.

McKerchar, M. 2001. *“Why Do Taxpayers Comply – Past Lessons and Future Directions in Developing a Model of Compliance Behaviour”*. (2001) 16 Australian Tax Forum 99.

McKerchar, M. Bloomquist, K. and Pope, J. 2013. *“Indicators of tax morale: an exploratory study”*. eJournal of Tax Research, Volume 11, Number 1, pp. 5-22.

Muklis, I. *“Tax Compliance for Businessmen of Micro, Small and Medium Enterprises Sector in the Regional Economy”*. 2016. International Journal of Economics, Commerce and Management United Kingdom Vol. IV, Issue 9, September 2016. United Kingdom. Accessed at: <http://ijecm.co.uk/wp-content/uploads/2016/09/498.pdf> (10 September 2017)

Netherlands Court of Audit. *“Peer Review of the Audit Board of the Republic of Indonesia”*. August 2009. Den Haag, Netherlands.

OECD. *“Economic Survey of Indonesia 2016”*. OECD. Paris. 2016. Accessed at: http://www.keepeek.com/Digital-Asset-Management/oecd/economics/oecd-economic-surveys-indonesia-2016_eco_surveys-idn-2016-en#.WZ_ge4SGPIU#page1

Prasetyo, K.A. *“Tax Administration Reform and the Society in Indonesia: Some Lessons Learnt.”* ATAX, UNSW, Sydney. 2016.

Accessed at: [https://www.business.unsw.edu.au/About-Site/Schools-Site/Taxation-Business-Law-Site/Documents/Tax Administration Reform and the Society in Indonesia Prasetyo.pdf](https://www.business.unsw.edu.au/About-Site/Schools-Site/Taxation-Business-Law-Site/Documents/Tax%20Administration%20Reform%20and%20the%20Society%20in%20Indonesia%20Prasetyo.pdf)

Prastowo, Y. 2017. *“New Perspective of Comprehensive Reform: Integrating Corruption Eradication and Tax Optimization Agenda”*. Tax and Corruption Symposium, ATAX, Sydney. 12th-13th April 2017. Accessed at: [https://www.business.unsw.edu.au/About-Site/Schools-Site/Taxation-Business-Law-Site/Documents/Wednesday PM Yustinus Prastowov.pdf](https://www.business.unsw.edu.au/About-Site/Schools-Site/Taxation-Business-Law-Site/Documents/Wednesday%20PM%20Yustinus%20Prastowov.pdf) (10 September 2017)

PwC. 2017. *“The Long View: How will the global economic order change by 2050?”*. PricewaterhouseCoopers LLP, February 2017.

Rablen, M.D. 2014. *“Audit Probability Versus Effectiveness: the Beckerian Approach Revisted”*. Journal of Public Economic Theory. 16 (2), 2014, pp. 322-342.

Rosid, A.; Evans, C.; Tran-Nam, B. 2017. *“Perceptions of Corruption and Tax Non-compliance Behaviour: Policy Implications for Developing Countries.”* Bulletin of Indonesian Economic Studies, 08 August 2017, p.1-44.

Sari, D. 2016. *“Risk Management and Taxpayer Compliance”*. International Conference on Education For Economics, Business, and Finance, Universitas Negeri Malang, Indonesia. Accessed at: <http://iceebf.um.ac.id/wp-content/uploads/2017/06/31.-Dr.-Diana-Sari.pdf> (10 September 2017)

Supreme Audit Office of Poland. *“Peer Review Report on the Supreme Audit Board of the Republic of Indonesia”*. April 2014. Warsaw, Poland.

Susila, B. 2014. *“The Compliance Costs of Large Corporate Taxpayers in Indonesia”*. PhD Thesis, Curtin University, Perth. Unpublished.

Whait, R. 2012. *“Exploring innovations in tax administration: a Foucauldian perspective on the history of the Australian Taxation Office’s compliance model”*. eJournal of Tax Research vol 10, no. 2, pp. 436-464

Whait, R. 2014. *“Developing risk management strategies in tax administration: the evolution of the Australian Taxation Office’s compliance model”*. eJournal of Tax Research vol 12, no. 1, pp. 130-161

Wickerson, J. 1994 (1). *“The Changing Roles of Taxpayer Audit Programs: Some Recent Developments in the Australian Taxation Office”*. Revenue Law Journal: Vol. 4: Iss.2, Article 5.

Widihartanto, S. 2014. *“Regulating Indonesia’s High Individual Taxpayers: Ideas for Policy Transfer”*. PhD Thesis, Australian National University, Canberra. Unpublished.

Wihantoro, Y., Lowe, A., Cooper, S., Manochin, M. 2015. *“Bureaucratic Reform in post-Asian Crisis Indonesia: The Directorate General of Tax”*. Critical Perspectives on Accounting 31 (2015) 44-63

World Bank. *“Report No: 76872-ID”*. 21 October 2013

Additional website resources accessed:

Australian National Audit Office. Accessed at <https://www.anao.gov.au/>

Bloomberg. 2016. *“Tax amnesty to cleanse Indonesia underground economy”*. <http://www.bloomberg.com/news/articles/2016-10-04/tax-amnesty-to-cleanse-indonesia-underground-economy-riady-says>

DBS Group Research. 2016. *“Indonesia: Tax revenues slipping”*. August 2016. Accessed at: http://www.dbs.com.sg/treasures/aics/templatedata/article/generic/data/en/GR/082016/160811_insights_indonesias_tax_revenues_slipping.xml

Evans, C., Rosid, A. and Tran-Nam, B. 2016. “*To get more people to pay taxes, Indonesia should stamp out corruption by officials at the top*”. The Conversation. 2 May 2016. Accessed at: <http://theconversation.com/to-get-more-people-to-pay-taxes-indonesia-should-stamp-out-corruption-by-officials-at-the-top-57512>

Indonesia Investments. “*What is the Problem with Tax Collection in Indonesia?*”. 10 October 2015. Accessed at: <http://www.indonesia-investments.com/finance/financial-columns/what-is-the-problem-with-tax-collection-in-indonesia/item6023>

Indonesia Investments. “*Tax Revenue Indonesia: Shortfall in 2015, Target 2016 Revised*”. 12 January 2016. Accessed at: <http://www.indonesia-investments.com/news/todays-headlines/tax-revenue-indonesia-shortfall-in-2015-target-2016-revised/item6366>

Indonesia Investments. “*Tax Revenue Indonesia 2017: Another Shortfall Expected*”. 5 December 2016. Accessed at: <http://www.indonesia-investments.com/news/todays-headlines/tax-revenue-indonesia-2017-another-shortfall-expected/item7412>

Indonesia Investments. “*Budget Deficit of Indonesia Under Control Thanks to Tax Amnesty*”. 05 January 2017. Accessed at: <http://www.indonesia-investments.com/finance/financial-columns/budget-deficit-of-indonesia-under-control-thanks-to-tax-amnesty/item7495>

Indonesia Investments. “*Fiscal Update Indonesia: Budget Deficit at 2.57% of GDP (Unaudited)*”. 2 January 2018. Accessed at: <https://www.indonesia-investments.com/news/todays-headlines/fiscal-update-indonesia-budget-deficit-at-2.57-of-gdp-unaudited/item8458>

Jakarta Post, [Print Edition]. “*‘Superbody’ plan brought back into action*”, 18 January 2017

Jakarta Post. 9 January 2018. “*Too high tax revenue target frightens businesspeople*”. Accessed at: <http://www.thejakartapost.com/news/2018/01/09/too-high-tax-revenue-target-frightens-businesspeople.html>

Pratomo, M.H. *Regulation Complexity and Large Business Tax Compliance in Indonesia*. Conference Presentation and Powerpoint Slides. Australasian Tax Teachers’ Association Conference, Wellington (NZ). 18-20 January 2017.

PwC Indonesia. *TaxFlash No.28/2015*. October 2015. Accessed at: <http://www.pwc.com/id/en/taxflash/assets/english/2015/taxflash-2015-28.pdf>

PwC Indonesia. *TaxFlash No.9/2016*. July 2016. Accessed at: <http://www.pwc.com/id/en/taxflash/assets/english/2016/taxflash-2016-09.pdf>

PwC Indonesia. *TaxFlash No.11/2016*. July 2016. Accessed at: <http://www.pwc.com/id/en/taxflash/assets/english/2016/taxflash-2016-11.pdf>

Taxprime. “*Tax Audit in Indonesia*”, 3 July 2014, accessed at <http://taxprime.net/tax-audit-in-indonesia/> [Note: Taxprime is an Indonesian specialist tax consulting firm, located in Jakarta, comprising a number of former senior DGT officials]

<http://thelawreviews.co.uk/edition/the-tax-disputes-and-litigation-review-edition-5/1140521/indonesia>