# Optimizing Administration Measures in the Financial Sector to Reduce Compliance Costs

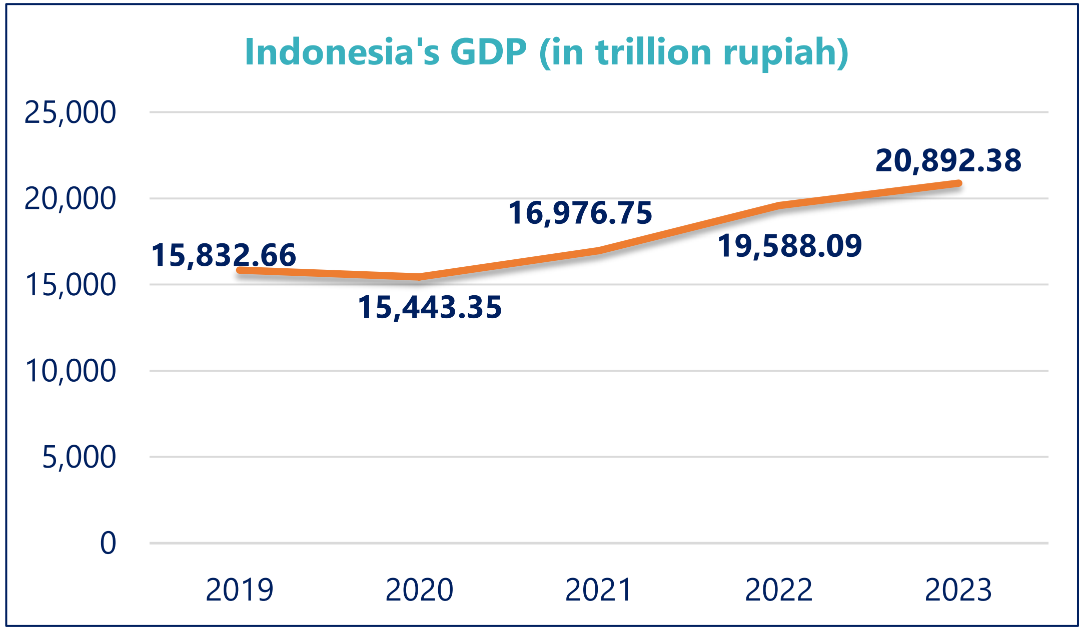
The 5th Belt and Road Initiative Tax Administration Cooperation Forum (BRITACOF)

24-26 September 2024

# Outline

# 1. Overview of the Financial Sector in Indonesia's GDP

# Overview of the Indonesia's GDP



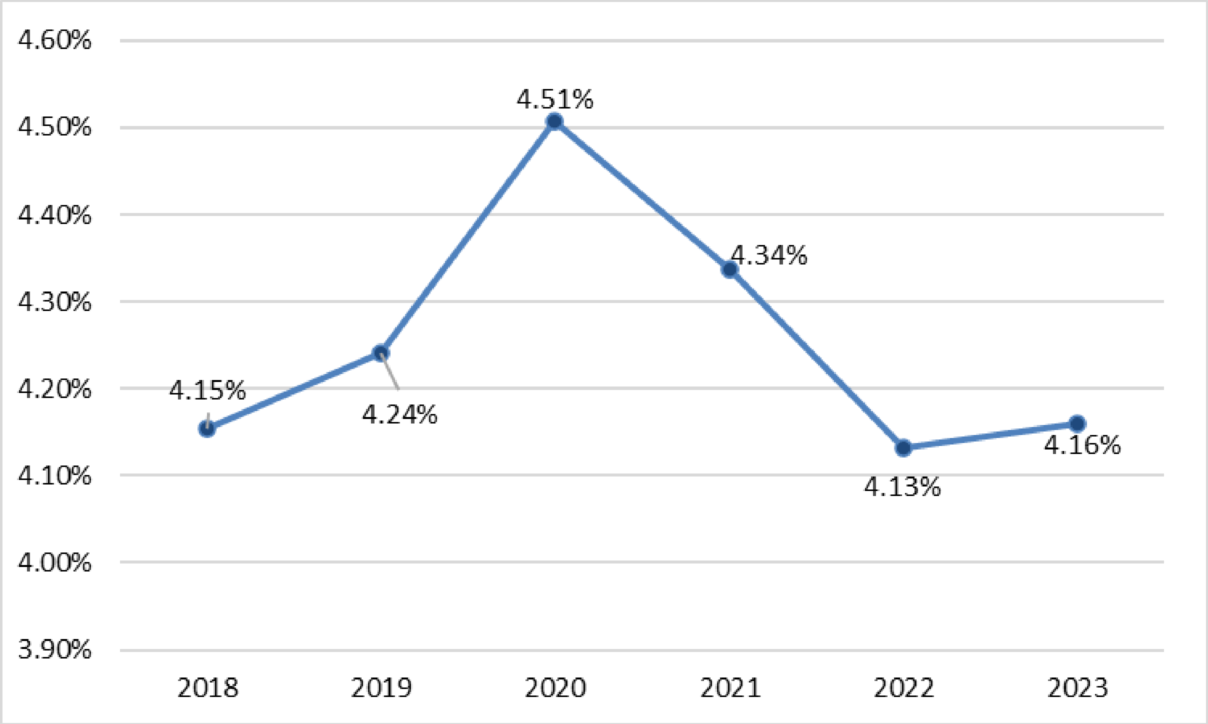


Source: BPS- Indonesia Statistics

- Overall, the Indonesia economy **has performed well during the last five years**. According to statistical data, Indonesia's GDP has consistently increased year after year.
- The Indonesian economy stays resilient in the second quarter of 2024, with GDP at **5.08%.**
- Indonesia's GDP in 2023 is recorded to have increased by **5.5%** over the previous year. During the 2018-2023 timeframe, Indonesia's GDP growth peaked at **5.31%** in 2022, and fell to -**2.07%** in 2020 because to the Covid pandemic.

# The Role of the Financial Sector in Indonesia's GDP

## Percentage of Financial Sector in GDP




Source: BPS- Indonesia Statistics
The data of Bank Indonesia come from the same source

- Although comprising only an average of **4.26%** of GDP each year, the financial sector plays a crucial role in Indonesia's economic growth, with **banks** representing the largest portion of this sector.

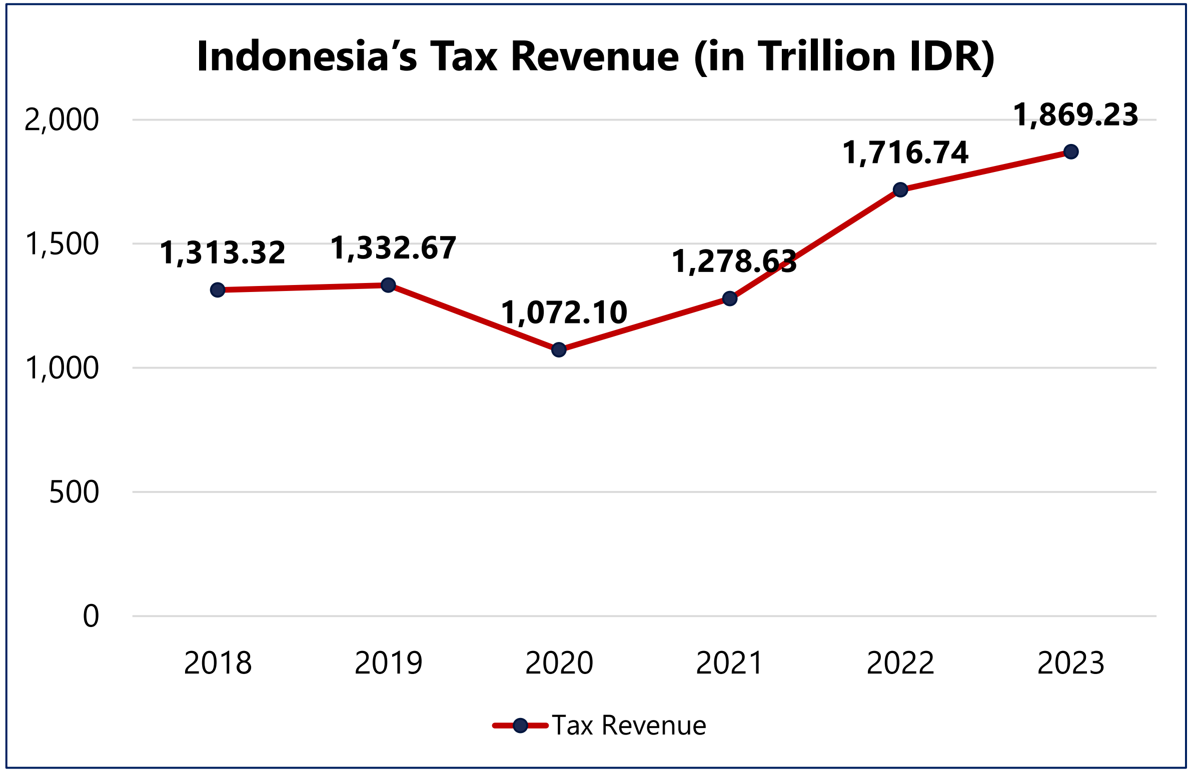
- Efforts to broaden **non-bank players** are underway, with initiatives focused on promoting **financial inclusion, expanding digital financial services, and improving the efficiency of savings and investment intermediation processes**.*

*World Bank, 2017
*Dr. Ferry Irawan and Adelia Surya Pratiwi, MSc., 2017

# 2. Overview of Financial Sector in Indonesia's Tax Revenue

# Overview of the Indonesia’s Tax Revenue



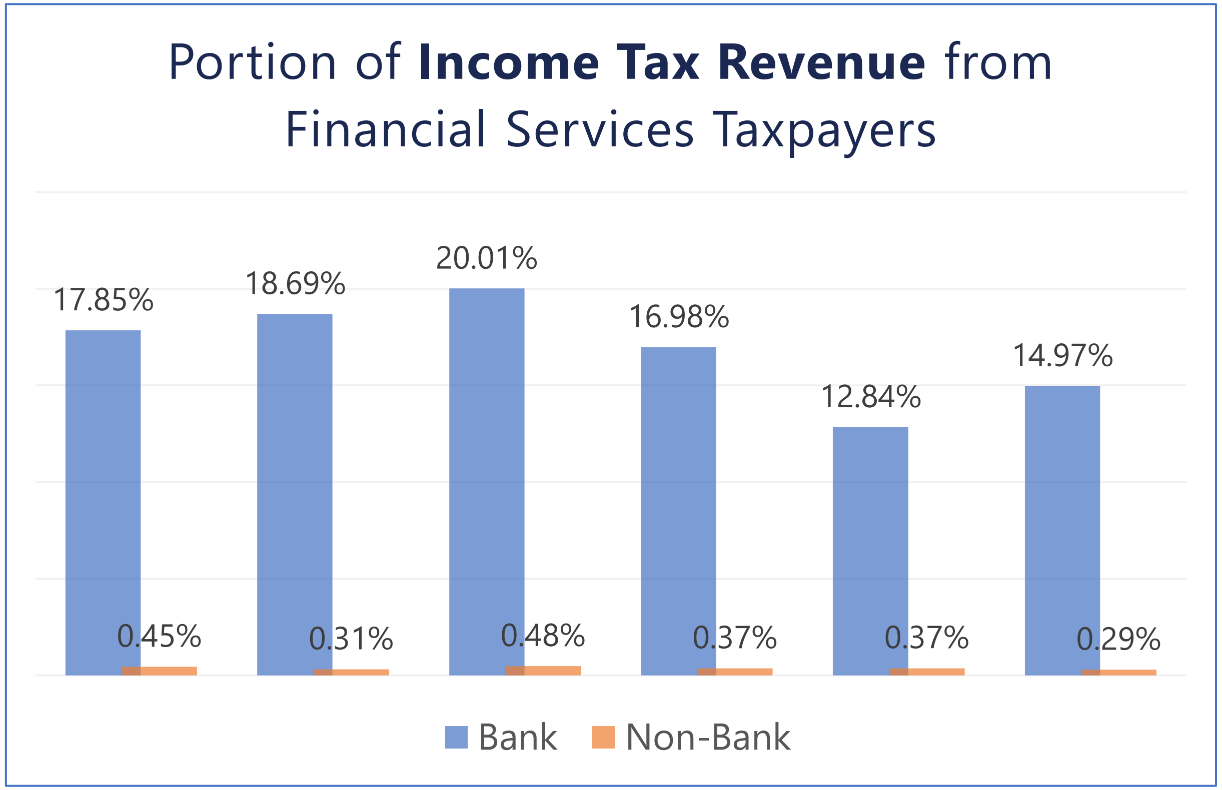


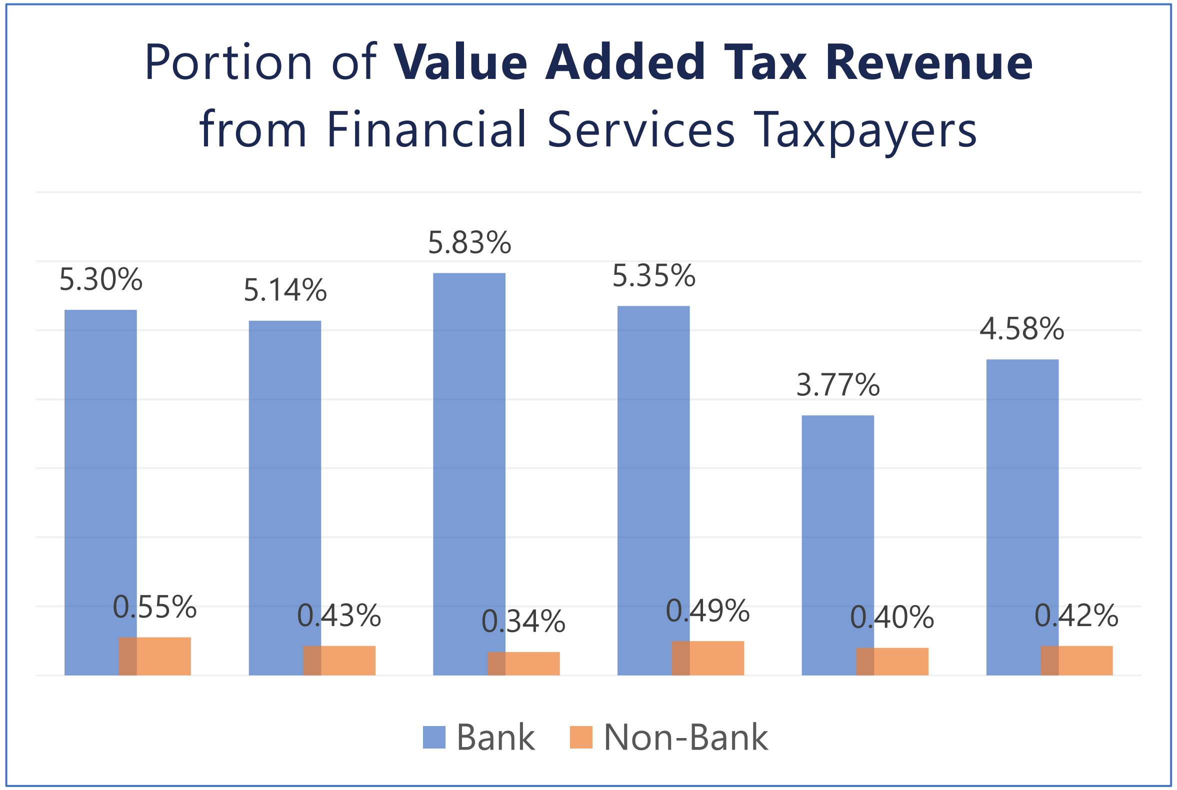

- Between 2018 and 2023, Indonesia's tax revenue demonstrated strong performance. According to the State Budget (APBN) financial report, the realization of tax revenue has shown a consistent **upward trend** each year.
- In **2023**, Indonesia's tax revenue reached **IDR 1,869 trillion**, marking the **peak** for the period. Conversely, during this timeframe, tax revenue hit its lowest point in **2020**, falling to **IDR 1,072 trillion** as a result of the Covid-19 pandemic.

Source: The State Budget Financial Note, and DGT annual performance report

# The Role of the Financial Sector in Indonesia’s Tax Revenue






Banking entities play a **significant role** in both **income tax** and **value-added** tax revenue in Indonesia.

# 3. Tax Regulations Related to the Financial Sectors

# Tax Regulations Related to the Financial Sectors



There are several **relevant tax regulations** to support economic stability, fairness, and efficiency, benefiting both the government and the broader economy. The key points of those regulations are as follows:

| Tax Classification | Regulation | Key Point |
|---|---|---|
| 1 **Income Tax for Financial Institutions** | **Regulation No. 7 of 1983** (Income Tax Law, amended with **Law No. 7 of 2021** on the Harmonization of Tax Regulations) | This law governs income tax for individuals and entities, including financial institutions. Financial institutions must pay corporate income tax on their profits at the standard rate of 22% (as of 2024), which is set to gradually reduce under specific conditions. |
| 2 **Value-Added Tax (VAT) for Financial Services** | **Regulation No. 8 of 1983** (VAT Law, amended with **Law No. 7 of 2021** on the Harmonization of Tax Regulations) | Financial institutions providing certain services such as loans, credit cards, and insurance are exempt from Value-Added Tax (VAT). However, other services not specified as exempt may be subject to VAT at the standard rate of 11%. |
| 3 **Value-Added Tax (VAT) on Foreclosed Collateral** | **Law No. 42 of 2009** on VAT and Sales Tax on Luxury Goods and **MoF Regulation No. 41 of 2023** on VAT of Collateral provide guidance on the VAT treatment of foreclosed collateral. | o If the foreclosed collateral involves **goods or property subject to VAT** (such as real estate or vehicles), the sale of these assets by the bank or financial institution may be subject to VAT.<br>o In order to provide legal certainty and simplify the administrative burden associated with the sale of seized collateral, MoF Regulation No. 41 of 2023 stipulating a VAT liability to a specific rate (effectively) of 1.1%. |

# Tax Regulations Related to the Financial Sectors



There are several **relevant tax regulations** to support economic stability, fairness, and efficiency, benefiting both the government and the broader economy. The key points of those regulations are as follows:

| Tax Classification | Regulation | Key Point |
| --- | --- | --- |
| 4 **Provisions for Loan Loss Reserves (Banking Sector)** | **Ministry of Finance Regulation No. 81/PMK.03/2009** (amended with MoF **Regulation No 219/PMK.011/2012**) allows banks to deduct loan loss reserves (or bad debt provisions) from their taxable income. This regulation aligns with the prudential standards set by Bank Indonesia (BI) and the Financial Services Authority (OJK). | o Banks are permitted to deduct provisions for loans classified as doubtful, substandard, or loss, as determined by BI or OJK.<br>o The deductible amount is based on specific criteria, such as the age of the loan and risk classification. This aligns with the risk-based approach that BI and OJK use to assess financial stability.<br>o The objective is to ensure that banks maintain adequate reserves for Non-Performing Loans (NPLs) while minimizing the impact on taxable profits.<br>o To provide legal certainty and align with developments in the financial services sector, the Directorate General of Taxes is currently drafting changes to the provisions related to NPL (Non-Performing Loans) reserves to accommodate changes in generally accepted accounting principles. |
| 5 **Deduction for Insurance Reserve Liabilities (Insurance Sector)** | For insurance companies, insurance reserves (technical reserves) related to claims and policyholder liabilities can also be deducted from taxable income under **Ministry of Finance Regulation No. 81/PMK.03/2009 (amended with MoF Regulation No 219/PMK.011/2012).** | o Insurance companies can deduct reserves related to life insurance and general insurance policies, as long as these reserves are recognized according to OJK's regulatory framework.<br>o General insurance companies can deduct reserves for outstanding claims, unearned premiums, and risk-based reserves.<br>o Life insurance companies can deduct reserves related to policyholder benefits, such as surrender values, premiums for guaranteed benefits, and liabilities for claims in process. |

# 4. The Role of Tax Administration in Strengthening the Financial Sector

# The Role of Tax Administration in Strengthening the Financial Sector



## Financial Sector Regulation

### Supporting the relevant regulatory and compliance requirements for the financial sectors

The relevant regulations include **NPL** and **CAR*** whose enforcement has been strongly supported by the existing **AEoI** agreement between DGT and OJK/BI:

**Non-Performing Loans (NPLs)** are loans overdue by 90+ days. OJK regulates NPLs, capping them at 5%, but relaxed this during COVID-19 to allow restructured loans to be classified as performing until early 2023.

**Capital Adequacy Ratio (CAR)** regulations require banks to maintain 8%-14% CAR, ensuring they can absorb losses and stay solvent during financial shocks, as mandated by OJK.

## Relevant Tax Regulation

### Aligning the Civil Registration Number (NIK) with the Taxpayer Identification Number (NPWP)

- By aligning the Civil Registration Number (NIK) with the Taxpayer Identification Number (NPWP), banks can **acquire more accurate information** about the identity and financial profile of **prospective borrowers**.
- This data assists banks in **assessing credit risk more effectively**, thereby reducing the likelihood of non-performing loans. **Tax information provides insights** into the financial capability and tax compliance of borrowers, crucial indicators in credit assessment.

### Utilization of tax data as in evaluating banks' operational viability

- In addition to the standard prudential regulations, tax data serves as an **indicator to measure the banks' operational viability**. This information encompasses income, expenditures, and tax obligations of banks, all essential for assessing financial stability and performance.
- Leveraging tax data **enhances transparency and accountability** within the banking sector. It aids regulators and investors in **making well-informed decisions** regarding the financial condition of banks.

## Result

**Lower compliance costs for financial institutions.**

Source:
- *Financial Service Authority (FSA)/OJK No 11/POJK.03/2016*
- *Bank of Indonesia (BI) Regulation No 15/2/PBI/2013*

# Utilization of Tax Data: The Automatic Exchange of Information (AEoI)

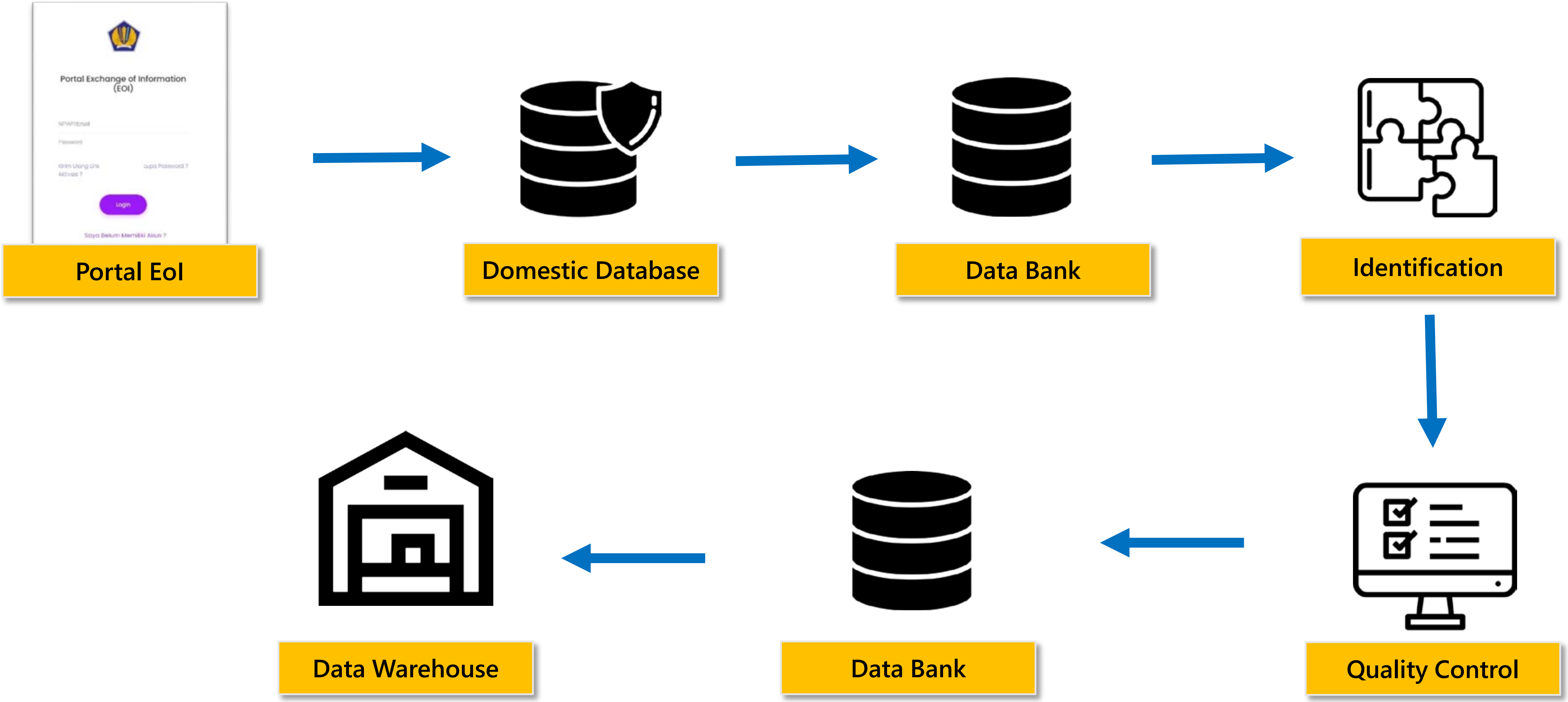


The utilization of tax data through the Automatic Exchange of Information (AEoI) is facilitated by **cooperation with financial authorities**.

| Key Tax Regulations for Information Exchange | Data Provided From Information Exchange | Information Exchange Procedures | Sanction |
|---|---|---|---|
| • **Law No 9 of 2017** on Financial Information Exchange for Tax Purposes<br>• **Minister of Finance Regulation No 70 of 2017** (Technical Guidance of Financial Information Exchange for Tax Purposes, amended with **MoF Regulation No 47 of 2024**)<br>• **Minister of Finance Regulation No. 228 of 2017** on Information and Procedures for Submitting Data and Information Related to Taxation | • Matching between inbound financial account EOI data and foreign income<br>• Financial balance<br>• Automatic Exchange of Information Domestic Accounts<br>• Collateral Data - Financial Information Services System (SLIK)<br>• Securities Ownership (Custodian Banks)<br>• OJK Borrower Loan Financial Statements | • Reporting by Financial Services Institutions (LJK) is carried out annually through the EoI Portal.<br>• Supervision of domestic data reporting is carried out by the Directorate of Data and Information (DIP), while supervision of foreign national data is carried out by the Directorate of International Taxation.<br>• DIP is responsible for receiving EoI data through the portal and monitoring compliance with financial information reporting. | Leaders and/or employees of financial service institutions, leaders and/or employees of other financial service institutions, and leaders and/or employees of other entities who:<br>a. fail to submit reports;<br>b. fail to properly implement financial account identification procedures; and/or<br>c. fail to provide information and/or evidence or explanations<br>shall be punished with imprisonment for up to 1 (one) year or a fine of up to Rp1,000,000,000.00 (one billion rupiah). |

# Domestic Automatic Exchange of Information (AEoI) Data Processing Workflow





# 5. The Role of Tax Authorities in Enhancing Tax Compliance within the Financial Sector

# Empirical Evidence related to Financial Institutions’ Tax Compliance



Financial institutions are more tax aggressive than their non-financial peers
(Efendi et. al, 2022)

## Background

- Financial institutions play a critical role in the economic recovery post-Covid 19 pandemics. However, the monitoring systems are **primarily focused on their prudential and intermediary aspects**. Recently, there are also growing concerns globally concerning the tax compliance of financial firms (IMF, 2010; OECD, 2009).

***The study utilized confidential tax return data of the 5,968 largest Indonesian firms from 2009 to 2017***

## Findings

- This study finds consistent evidence of **reduced tax burdens of financial firms** relative to non-financial firms, suggesting financial firms exploit their opportunities of tax avoidance.
- The study found **simultaneous tax shelters, temporary differences, and permanent differences** by financial firms, indicating that these firms favour the most sophisticated and less costly techniques to minimise their tax burdens.

## Recommendations

- Financial authorities need to consider firms’ tax compliance in evaluating financial institutions operational viability.
- Tax authorities need to **assign more monitoring resources** to restrict tax sheltering activities and the opportunistic use of permanent differences and temporary differences.
- Better coordination between financial authorities and tax authorities is critical.

# The Role of Tax Authorities in Enhancing Tax Compliance within the Financial Sector



The efforts of the Directorate General of Taxes in addressing tax aggressiveness.
Overview of the Business Process for Supervision (SE-05/PJ/2022).

## 1 Planning

1. Supervision Plan Development
2. Prioritization of Supervision

## 2 Implementation

1. Filing Compliance Review
2. Reporting Compliance Review
3. Request for Explanation of Data and/or Information
4. Taxpayer Visits

## 3 Follow-up

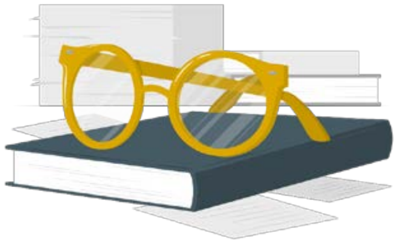
1. Recommendations for Examination
2. Recommendations for Comprehensive Tax Audits
3. Recommendations for Observation and/or Intelligence Operations
4. Recommendations for Taxpayer Valuation
5. Recommendations for Changes to Taxpayer Data and/or Status
6. Recommendations for Administrative Adjustments to Services and/or Facilities
7. Notification to Taxpayers
8. Recommendations for Correction of Legal Products

## 4 Monitoring and Evaluation

1. Supervision Monitoring at Head Office of DGT
2. Supervision Monitoring at Regional Tax Offices (Kanwil DJP)
3. Supervision Monitoring at Local Tax Offices (KPP)
4. Supervision Evaluation at Head Office of DGT
5. Supervision Evaluation at Regional Tax Offices (Kanwil DJP)
6. Supervision Evaluation at Local Tax Offices (KPP)

# 6. Tax Incentives for the Financial Sector

# Tax incentives for the financial sector





| | | RULES | Explanation | |
|---|---|---|---|---|
| 1 | Mutual Fund | Government Regulation Number 49 years 2021 | 7,5% rate on final income tax | Lower Tax Rate |
| 2 | Derivative | Government Regulation Number 31 years 2011 | In accordance with normal tax rate | Normal |
| 3 | Provisioning cost for bad debts | Ministry of Finance Regulation number 219 years 2012 | Deductible Expense | Lower Net Profit |
| 4 | Final Income Tax on Deposit Interest | Incone Tax Law number 7 years 1983 as amended by Harmonization of Tax Regulation Law number 7 years 2021 | 10% - 20% Final Income Tax | Lower Tax Rate |

# 7. Future Plan: Indonesia's Core Tax Administration System (CTAS/Coretax)

# Development of Tax System Using COTS



*To **minimize compliance cost** in the financial industry, the development of a tax system using COTS is essential.*

## Commercial Off-The-Shelf (COTS) based Taxation System

- The system is already operational (mature) and has implemented best practices for management.
- The system is ready to be customized (configured) to meet the tax administration requirements of its users.
- System development and implementation can go faster.
- To be deployed, business process changes (redesign) are required.

## Lesson learned from countries implementing COTS

- Demands a strong commitment from all government officials and institutions.
- Dedicated project management team with special incentives.
- It is necessary to amend regulations to conform to the revised business process design (business process redesign).
- Once a cots-based system has been developed
  - Future system modifications are simpler to implement
  - It is simpler to develop new digital services
- The focus of system development is to provide taxpayers with better services.

## Countries with COTS-based taxation regime

- Finland
- New Zealand
- Poland
- Australia
- Canada
- Netherland
- France
- Morocco
- Estonia
- Saudi Arabia
- India
- Vietnam
- South Carolina (US)
- North Carolina (US)
- Pennsylvania (US)
- Connecticut (US)
- New Mexico (US)
- Washington (US)
- Georgia (US)
- Kentucky (US)

# Benefits of Core Tax Administration System (CTAS) for Taxpayers



## Conditions Before Coretax Implementation

- Limited service channels, many of which are **still not automated (manual)**.
- Service portals that are **not yet integrated** (still distributed across several applications).
- **System transparency and accountability are still relatively low** (no features such as Tracking or a 360-degree view that Taxpayers can access).

## Conditions After Coretax Implementation

- **Expansion of tax service channels** for taxpayers through websites/applications, call centers, and tax offices.
- Increasing the number of **self-services** through digital channels.
- **A single taxpayer portal** with **integrated** services.
- Taxpayers can examine **available profiles and transaction history.**
- Taxpayers **can monitor** the process of submitting tax services so that there is **certainty of service completion**.

# Development Focus and Expected Benefits from Coretax



## Development Focus

### Development Focus for Taxpayers

1. Tax administration services are becoming more automated and computerized, with self-service and automatically filled tax returns (pre-populated)
2. Taxpayer account transparency that allows Taxpayers to see all transactions (360-degree view) so that it is easier for Taxpayers to fulfill their tax rights and obligations
3. Fast tax services are accessible from various channels (omnichannel) and can be monitored in real-time by Taxpayers (tracking)
4. Supervision and law enforcement that is more equitable for taxpayers through the implementation of compliance risk management (risk-based compliance)

### Development Focus for DGT

5. Providing more credible data information (valid and integrated)
6. Expanding the third-party data integration network
7. Establishing a knowledge management system to aid in decision-making
8. Managing tax administration based on data and knowledge (data- and knowledge-driven organization
9. Supporting the provision of more prudent and accountable DGT financial reports (revenue accounting system)

## Expected Benefits

**1.** Taxpayer compliance costs decrease

**2.** Increased efficiency and effectiveness of tax collection

**3.** Reduced risk of fraud

Increased voluntary compliance

**Increased Tax ratio**

# 8. Current Issue in Indonesia's Financial Sector: Underground Economy

# Financial Sector's Role to Reduce Underground Economy



*In exchange, financial authorities need to give efforts to **curb underground economy...***

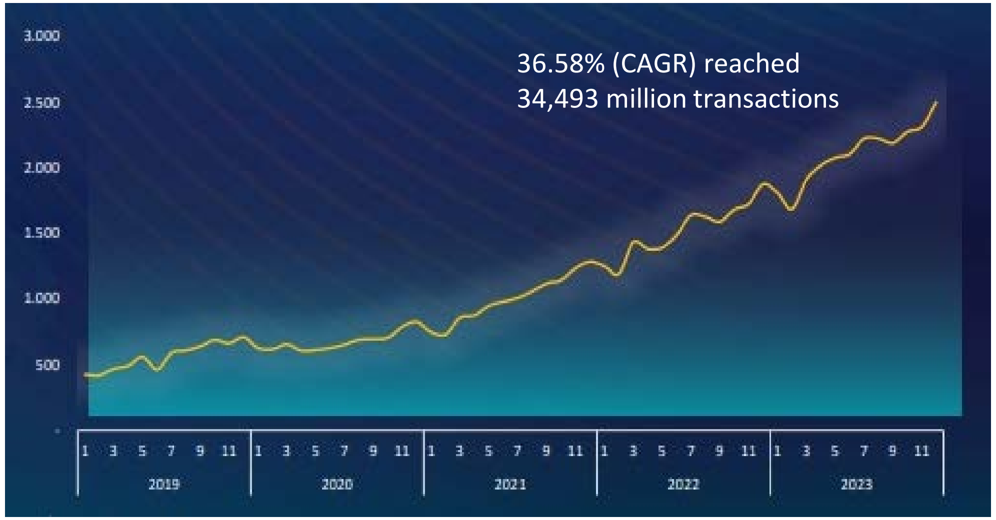
**Underground economy** is economic activities both legally and illegally missed from the calculation of Gross Domestic Product (GDP) (Scheineider & Enste, 2000)

To reduce the underground economy, the financial sector have some roles, such as* :

1. Enabling the surveillance of business transactions and facilitating tax compliance so it can reduce the incentives for firms and individuals to evade taxes and operate in the shadow economy
2. Integrating technology, such as digitalization in finance, enhances the efficiency of financial transactions and improves monitoring capabilities so it can reduce the opportunities for engaging in underground economic activities.
3. Increasing in cashless payments. A study on 57 countries from 2010 to 2015 found that an increase in cashless payments, such as debit and credit card transactions, **can decrease the size of the shadow economy because it increase traceability and reduce anonymity.****

Digital transactions have played an important role in supporting an inclusive national economy in Indonesia in several ways such as **enabling** many unbanked people to access financial services that improving financial inclusion, **encouraging** economic growth in Indonesia because it provides new options for the public to have access to financing and **increasing** productivity and facilitate financing for entrepreneurs, especially MSMEs.

Digital Payment Transactions (in million)




Source: Bank Indonesia, 2024

| | |
|---|---|
| **Digital Payment** | • **60,3k trillion**<br>• **( 3 x Indonesia GDP)** |
| **Banking Digitalization** | • **90% of commercial banks have digital channels (mobile & internet).** |
| **Financial Inclusion Ratio** | • **88,7% (Susenas, 2023)**<br>• **49% → 53% (World Bank, 2022)** |

Source: Bank Indonesia, 2024

*Bui Dan Thanh,2024

**Muzafar Shah Habibullah, 2021

# 9. Conclusions and Recommendations

# Conclusions



1

The financial sector, as a key pillar of the modern economy, plays a **significant role** in driving economic growth and optimizing resource allocation. A **robust and advanced** tax administration system is **crucial** for accelerating the transformation and innovation of the financial sector, while fostering the development of economic entities.

2

**Tax authorities can assist** in optimizing **relevant regulatory** and **compliance requirements**, encouraging financial institutions to strengthen internal risk controls, combat financial crimes, and protect market order and consumer rights—all while **minimizing compliance costs**. Tax policies have a direct impact on the profitability and product innovation within financial institutions. Through closer **cooperation with financial authorities**, tax authorities can support financial authorities in improving tax compliance management, reducing tax risks, and enhancing sustainable development.

3

The Indonesian tax authorities have made **efforts to assist the financial sector** in reducing compliance costs, including through **automatic data exchange (AEoI)** policies, drafting **financial sector tax regulations**, implementing tax compliance **supervision policies**, providing **tax facilities** for financial sector, developing a new COTS-based tax system, namely the **Coretax system.** In addition, financial authorities need to give efforts to **curb underground economy**.

4

Looking forward, tax authorities can also **share data with financial authorities**, in accordance with regulations, to aid in risk identification, early warning, and the reduction of non-performing assets and financial risks.

# Recommendation



1

- Incorporating **tax compliance** as a key element in evaluating banks' operational viability including timely reporting of tax returns, timely payment of taxes, as well as accurately reporting all incomes based on actual conditions.

2

- Tax authorities share **relevant tax information** (assets, business turnover, tax liabilities) to monetary authorities in assisting banks assess their prospective borrowers.

3

- The **alignment of tax regulations** on reserve formation with Financial Services Authority (OJK) policies.

# *Thank you*

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