OCBC TREASURY RESEARCH

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Tax Tweaks

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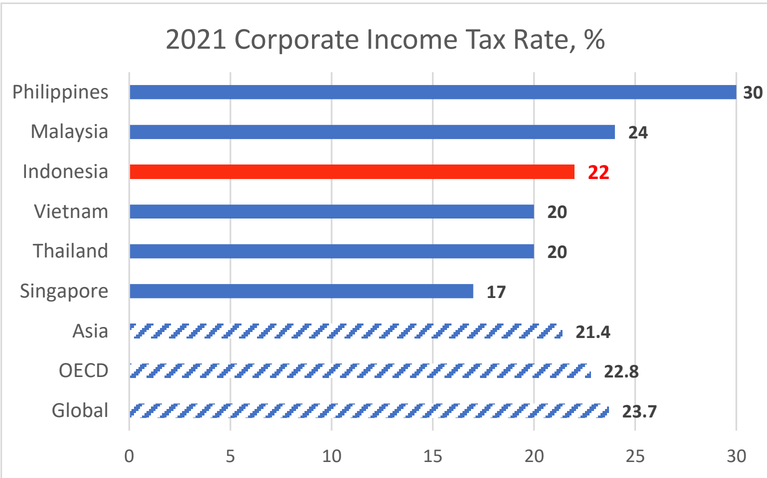
Indonesia's new tax law signals it's serious about fiscal consolidation

- Indonesia's parliament has just approved a tax reform bill which shows that the government is keen on keeping its deficit in check despite the pressure to boost growth. For one, it walked back on its earlier plan to cut the corporate tax rate further to 20% in 2022 to put it on par with regional FDI competitors such as Vietnam. Instead, it will stay at the current rate of 22%,
- It also introduced some 'Robin Hood' changes to the individual income tax. The first layer of taxable income has been increased from IDR50mn to now IDR60mn at a rate of 5%. At the other end, a new tax bracket has been created, for those earning over IDR5bn a year, with a hefty tax rate of 35%.
- Somewhat curiously, another round of tax amnesty is also introduced, perhaps with the view towards delivering a one-off boost to government revenue next year. Unless it is coupled with a concrete threat of tougher tax enforcement, however, it may receive a lukewarm response. Separately, a carbon tax has also been introduced, but at a fairly low rate and limited in scope – sign of how tough it is for authorities in Indonesia (and indeed anywhere) to balance the need to fight climate change and boost recovery.

Curtailed Cut

It was going to be one of the key parts of Indonesia's push towards levelling the playing ground against regional FDI darlings such as Vietnam, but alas, the plan to cut the corporate tax rate to 20% in 2022 has proven to be too fiscally costly to be followed through. Instead, it will stay at the 22% rate that has been applicable since the start of this year.

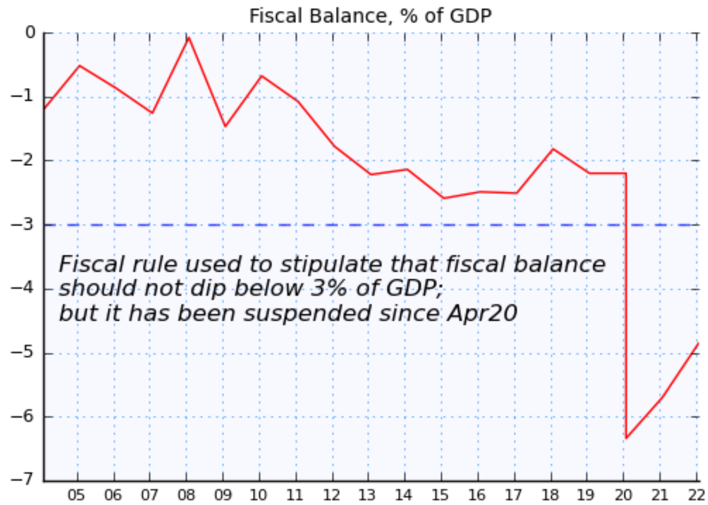


Source: OCBC, KPMG.

The glass-half-full way of looking at it is that at least the tax rate did not revert to the 25% that it had been at previously. Nonetheless, at 22%, the corporate income tax rate for Indonesia is still at the higher side of regional average and even if some specific industries may enjoy tax incentives, the fact that the tax cut plan did not come through – and with little indication that it is merely postponed and may yet be carried out one day – is perhaps a missed opportunity for Indonesia to increase its FDI attractiveness.

Consolidation must go on

The fact that the government opted to walk back on the plan to reduce the corporate income tax rate further speaks volumes of the near-term fiscal priority that it has, that is consolidation.



Source: OCBC, Bloomberg.

Having suspended its fiscal deficit rule – of having no more 3% of GDP – last year due to the pandemic for three years, the authorities including Finance Minister Sri Mulyani have been highlighting that they remain serious about returning to the rule by 2023 despite the difficulties posed by the pandemic resurgence. This includes pencilling in a relatively subdued deficit of 4.85% of GDP for Budget 2022, compared to the 2020's 6.34% and what is likely to be 5.7% this year.

By sticking to the 22% corporate tax rate rather than cutting it further, it has won itself some wiggle room to keep to the deficit target next year. Given how the virus can sneak up and pose a resurgence risk, preserving some fiscal space especially with the overarching goal of keeping the deficit in check in mind makes better sense.

High VAT content

Elsewhere, in another move to ensure enough revenue inflow to keep deficit in check, the new tax bill has also allowed the government to increase its VAT rate from 10% to 11% in April next year (and to 12% by 2025). Given that VATs typically contribute 43.5-46% of total tax intake, the rate uptick can offer a sizable fiscal boost.

Moreover, some categories have become newly liable for the VAT as well including basic daily necessities such as rice, milk, fruits and vegetables that are classified as *sembako* locally. The government is keen to emphasize that only imported “luxury” *sembako* will be taxed, although how it can operationalize the distinction effectively remains an open question.

Given how the poor would typically spend a higher proportion of their income on food and other basic necessities, unless the VAT roll-out is carried out well, it could present a potential upside risk to inflation at a time of heightened concerns about uptick in prices of commodities, including in agricultural goods.

Robin Hood Brackets

Perhaps with a view towards battling inequality better, but also to help increase the tax revenue intake, the government has also introduced a new tax bracket for the most well-off in the society.

Indonesia's Individual Income Tax Brackets

Current		*New*	
Annual Income in IDR	**Tax Rate**	**Annual Income in IDR**	**Tax Rate**
Up to 50mn	5%	**Up to 60mn (~USD4200)**	**5%**
50mn - 250mn	15%	60mn - 250mn	15%
250mn - 500mn	25%	250mn - 500mn	25%
Over 500mn	30%	500mn - 5bn	30%
		Over 5bn (~USD350k)	**35%**

Source: OCBC, various media outlets.

Indonesians earning more than IDR5bn, or roughly USD350k a year, can now enjoy having a new tax category of their own, with 35% tax rate, 5 percentage points more than the previous top tax rate.

Meanwhile, some people at the other end of the spectrum can look to lower tax rate. The lowest-rate bracket of 5% tax is now applicable for incomes of up to IDR60mn (~USD4200) versus IDR50mn before.

Pardon me, again?

Among all the items detailed in the tax reform bill, perhaps the one that might end up raising most eyebrows is the reintroduction of tax amnesty.

Indonesia's Tax Amnesty II: Tax Tariffs

Asset Status	**Invested in sovereign bonds, natural resources processing, or renewable energy sector?**	**Assets acquired in 1985-2015**	**Assets acquired in 2016-2020**
Onshore or offshore assets that are repatriated	Yes	6%	12%
	No	8%	14%
Offshore assets that will not be repatriated		11%	18%

Source: OCBC, various media outlets.

The last one that was introduced in mid-2016 and lasting through to early 2017 was meant to be a one-off, after all. Hence, there is an element of moral hazard that might surface, given the return of such initiative just 5 years later.

After all, any tax evaders might ask themselves, if the tax authority has not caught on to the evasion they were doing in the past half a decade after they refused to go for the amnesty deal back then, what are the incentives to do so this time round?

This may be especially so for offshore assets, which might can be dealt a rather punitive tariff of as much as 18%, depending on factors such as date of asset acquisition, repatriation intention and investment allocation. Comparatively, back in the 2016 amnesty, the maximum tariff was 10%.

To enhance the effectiveness of the program, the government will have to step up its tax enforcement and audit mechanism. Otherwise, the amnesty program may just present a one-off revenue uptick, from the tariffs on any assets that are coming clean until the program ends, rather than sustainably broaden the tax base for future revenue streams.

Baby Steps

The new tax law offers a debut for carbon tax in Indonesia, signalling that the Indonesian authorities are keen to help tackle the climate change issue in the years ahead.

However, while the overall intention is clear, the steps taken thus far remain small and limited. For one, the carbon tax rate is set at IDR30,000 (~USD2.1) per kg of CO2e, watered down sizably from IDR 75,000 in the original plan. The IMF, for one, argued that the carbon tax rate needs to be set as high as $75 in Asia to have a positive effect on the climate change battle. (For backgrounders on carbon tax and more, please click here and here.)

Moreover, the rollout of the carbon tax will only be applicable to a narrow set of coal-powered electricity generators, rather than other heavy energy users such as cement manufacturers, as well.

Broadly speaking, while the introduction of carbon tax is a welcomed move, the low rate and limited scope signal that the government remains cautious of the challenges presented by such new initiative on an economy that is still trying to recover from bouts of pandemic-caused damage.

Growth impact

Viewed as a total package, the new tax bill may present some headwinds to growth in 2022, even if the limited nature of measures such as on the carbon tax introduction as discussed earlier helps to cushion the impact. For one, the uptick (and broader application) of VAT may limit the recovery pace of consumption that remains a key component of the overall economy.

The return of tax amnesty together with the introduction of high-income tax bracket may also limit the high-end consumption. The former, for instance, may compel the more well-off to stay away from the more conspicuous consumption, due to concerns that the tax authorities may ramp up their audit and investigation activities during the period.

All in all, the very fact that the authorities went ahead with these changes despite such growth headwinds tells us, again, that in the near-term, they would prioritize fiscal consolidation ahead of growth. It is a tough thing to balance but given the unsettled global yields environment of late, probably the wiser choice.

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