INNOVATIONS FOR SUCCESSFUL SOCIETIES

BROADENING THE BASE:
IMPROVING TAX ADMINISTRATION IN INDONESIA, 2006–2016 (SHORT VERSION)

This summary draws on an ISS case study with the same title title can be found on the [ISS website](). Leon Schreiber drafted the full case based on interviews conducted in Jakarta, Indonesia in January and February 2018. Case published April 2018. Summary published in May 2019.

BACKGROUND

Tumult marked the first decade of the twenty-first century in Indonesia. Public confidence in government was low, and inefficiency and corruption confounded tax collection and other government programs. In 1998, the Asian financial crisis had caused GDP to plunge by more than 13%, and as the economy contracted, tax revenues fell to just 8.6% of GDP. Tax revenue had plummeted during the crisis, and the collection rate in 2005 remained well below accepted standards, as well as below the levels of many of Indonesia's peers in the region.

Indonesia had never managed to reach the 15% tax-to-GDP threshold that the International Monetary Fund generally recommended as a sustainable ratio, and in December 2005, President Susilo Bambang Yudhoyono recognized the need for action. Yudhoyono, who had won election the previous year on a pledge to build prosperity and fight corruption and government inefficiency, appointed respected economist Sri Mulyani Indrawati as finance minister. One of Mulyani's first significant moves came in April 2006, when she appointed fellow economist Darmin Nasution as director general of taxes.

Nasution and his senior leadership team took on the daunting task of cleaning up the tax office, increasing efficiency, and building public confidence. In 2010, the sensational trial and conviction of Gayus Tambunan—a junior official at the Directorate General of Taxes (DGT) who had become rich by doctoring tax returns for hundreds of companies and wealthy individuals and colluding with the tax courts to help his benefactors avoid steep penalties—became a cause célèbre for Indonesians fed up with Indonesia's tax system. The case underscored the challenges that Nasution and his successors confronted.

KEY ISSUES

- Indonesia's tax collections had failed to recover substantially from the effects of the 1998 Asian financial crisis.
- The Directorate General of Taxes had a disjointed structure. Many of its numerous offices, spread across the sprawling island nation and serving a population of more than 200 million, had tenuous relationships with the headquarters operation.
- Staffing was short, and many employees lacked adequate skills to do their jobs.
- The tax authority had an antiquated information technology system.
- A perception of widespread corruption in the tax system, favoring the rich and powerful, was an obstacle to getting more people to register to pay taxes.
- Legislatively approved tax breaks for businesses and a narrow tax base hampered efforts to increase the tax-to-GDP ratio.

REFORM STRATEGY

In 2006, the DGT's new leaders launched a nationwide overhaul after drawing lessons from a successful pilot program that had reorganized the directorate's biggest offices and enabled large taxpayers to settle all of their tax-related affairs with a single visit to one office rather than having to go through multiple steps.

Expanding the large-taxpayer-office pilot to more than 300 locations across a 3,000-mile archipelago and to taxpayers at all levels presented no small challenge. The implementers (1) built a digital database that linked all offices to a central server in the capital of Jakarta, (2) developed competency testing and training that bolstered staff quality, and (3) created new positions to improve relationships with taxpayers. Other measures aimed to reduce corruption and tax fraud.

When political and practical crosscurrents frustrated the DGT's efforts to build the workforce its leaders thought was needed, the agency turned to big-data analytics to improve compliance and broaden the tax base.

ACTIONS TAKEN

In mid 2006, the DGT—emulating the large-taxpayer-office system it had set up in Jakarta—began transforming its entire business process from one based on segmentation by tax type to division by taxpayers' income levels and needs. The transformation required reorganizing all of Indonesia's tax offices and empowering them not only to process individual income taxes, value-added taxes (VAT), corporate taxes, and property taxes but also to carry out their own audits. The DGT also created the new, high-skill position of account representative—a single employee who would work with an individual taxpayer rather than a system wherein different people handled different aspects of each taxpayer's affairs. In 2008, the DGT marked the completion of the conversion with a tax amnesty that generated 7.46 trillion rupiah (US$813.14 million) in revenues and registered 5.6 million new taxpayers.

To help regional and local offices with staffing and capacity building, the head office created a new internal affairs and human resources transformation directorate, which drew up clearer rules to guide decisions involving promotions and transfers between offices. Competency tests gave administrators a way to match staff to the roles staff would take on under the new structure. To bring compensation in line with market rates, employees across the finance ministry, including the DGT, received hefty pay raises aimed at boosting morale and efficiency and reducing incentives for corruption.

Further aiding in the reorganization, the DGT rolled out a new software system to every regional-, medium-, and small-taxpayer office—about 400 offices in total. Based on the Oracle platform, the system enabled case management by automatically saving and logging any changes in each taxpayer's account, recording who made the changes, and making it possible for tax officers to quickly check the status of any taxpayer. After hitting a snag in 2009 when Nasution left the tax office and the official who headed the installation of the new system transferred out of the head office, the DGT finally finished installing the system in the remaining locations in 2012. With all 400 of the country's large-, medium-, and small-taxpayer offices connected to a centralized database, the organization finally had access to real-time information on transactions that took place across the country.

In 2009, new DGT head Fuad Rahmany partnered with the country's anticorruption commission, known as the KPK, to crack down on corruption in the agency, focusing especially on auditors who were suspected of colluding with taxpayers. In addition, he created a "dream team" of trustworthy auditors to review the work of their colleagues, thereby sending the message that offenders would be tracked down and punished. Part of the effort was an internal whistle-blower system that enabled DGT employees to report suspected corruption anonymously by using an internal web page.

Not all of the tax revenue lost through corruption involved DGT staff. Two of the biggest sources of fraud were (1) companies that filed false returns so as to minimize their tax burdens and (2) businesses that colluded with invoice mills to submit false invoices and claim bogus VAT refunds. Although the DGT had created an intelligence and investigations subdirectorate in 2007, it continued losing revenue to fraud. In 2009, the DGT upgraded the subdirectorate to a full directorate with the power to pursue criminal charges through the courts. When the cheaters adapted by inflating actual VAT claims instead of filing entirely fraudulent ones, the DGT developed an electronic invoicing system and in June 2016 changed its regulations to require all registered enterprises to upload their invoices to a central database on a continuing basis.

The DGT also faced the challenge of convincing the public the agency had changed. In the wake of the 2010 Gayus trial, a public affairs subdirectorate, which had begun operating in 2007, created and disseminated messages to staff about the DGT's core values of integrity and professionalism. The subdirectorate also sought to build public trust (1) by challenging the perception that most tax money was pocketed by government officials and (2) by persuading Indonesians that paying taxes benefited society. The team came up with a slogan it used in all advertising campaigns—"Our taxes are for us"—and it posted at government construction sites signs that read "Built with our tax."

Because surveys also showed that most taxpayers did not understand certain important aspects of the tax system, the team launched a nationwide taxpayer education effort: the DGT opened a call center dedicated to assisting taxpayers, began a campaign to introduce university students to the purposes of taxation, launched an annual Spectaxcular festival in the capital, Jakarta, where people could take care of all of their tax affairs, and used social media to reach Indonesia's young and tech-savvy population.

Still faced with staff shortages that hampered efforts to expand the tax base and with pervasive, legislatively approved tax exemptions that limited collections and distorted the system—which added to perceptions of unfair treatment—the DGT in 2018 turned to technology to fix the problems. A team of developers built a sophisticated set of big-data analytical tools that enabled the tax office to analyze internal as well as external data so it could track down potential taxpayers who were not registered and so it could improve registered taxpayers' compliance. But the lack of uniform data in the existing system made the project difficult and expensive.

RESULTS

From 2005 to 2016, the number of registered taxpayers in Indonesia jumped to 36 million from 3.8 million, and the number of people who filed annual tax returns grew to 12 million in 2016 from 1.2 million in 2005. Despite clear progress in broadening the country's tax base, the DGT estimated that in 2016, 44 million people ought to have been registered for taxes, 9 million more than the actual total. In addition, 16.5 million should have submitted tax returns, as opposed to the 12 million who did, meaning that 4.5 million had failed to submit their returns as required.

From 2007 to 2012, the DGT's annual collection of total tax revenues nearly doubled to $115 million from $58 million before dropping to $84 million in 2017. But the increase in revenues barely managed to keep up with the country's overall economic growth rate, which averaged more than 5.5% during the same period. Indonesia's overall tax-to-GDP ratio thus did not show significant and sustained increases. The initial creation of the large-taxpayer offices, which in some years had accounted for more than 40% of total taxes, contributed to an increase in the tax-to-GDP ratio to 13% from

11% during the mid 2000s. Revenues reached 14.2% of GDP in 2008 following the tax amnesty policy but declined again to just 11.8% in 2015.

After a decade of reform, the most clear-cut example of success resulting from the tax office's reform effort remained the DGT's creation of the highly efficient large-taxpayer offices in Jakarta during the mid 2000s. Still, the agency's decision to apply the large-taxpayer-office organizational model across the country and to all classes of taxpayers enabled it to move away from a system in which different offices dealt with different tax types and instead, toward a framework in which all offices managed all taxes. A World Bank Doing Business report showed that the change reduced the burden on taxpayers. From 2008 to 2016, the time that businesses spent in complying with tax requirements shrank to 221 hours per year from 266 hours, and the number of required payments per year fell to 43 from 51.

Ultimately, however, the DGT's inability to gain legislative approval for expanding its staff left it dependent on unproven technological methods for meeting the challenges of expanding the tax base and improving collections.

LESSONS LEARNED

- Implementing a staffing-intensive reform—the addition of account representatives to provide a single point of contact for taxpayers—was problematic in a system in which the DGT lacked autonomy to increase its budget and the size of its staff.
- Lack of uniform data made it difficult to expand technological solutions to compensate for the short staffing.
- Across-the-board application of a solution conceived for large taxpayers created problems of balance when applied to much more numerous classes of taxpayers.