

**CHAPTER 12**

**LESSONS FROM INDONESIAN TAX  
ADMINISTRATION REFORM PHASE 1  
(2001-2008): DOES GOOD GOVERNANCE MATTER?**

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**INTRODUCTION**

The Government of Indonesia has been reforming tax administration since 2001. This current reform has infused good governance elements to increase taxpayer compliance, to enlarge public trust in tax administration, and to improve the productivity of tax officer. This paper exposed that the reform was successful in generating tax revenue but not so successful in increasing taxpayer compliance. Also, it takes a great deal of time to have the best results of the implementation of good governance elements, particularly in a country which had been disregarding good governance practices for long time.

In undertaking tax reforms, any government needs to take into account the concomitant tax administration reform, since weak tax administration will become obstacle for achieving the objectives of tax reform. The tax administration needs to achieve the highest possible degree of taxpayer compliance, and to administer the tax laws efficiently, effectively and fairly, with the highest degree of integrity of its human resources. Then, the high public respect to the tax authority will come.

Since 2001, the Government of Indonesia has been implementing the Modernization of Tax Administration Program as part of the current fourth major tax reform. The current reform incorporated good governance elements and initiatives to create a more effective and efficient administration by making procedures more transparent, ensuring that the systems more accountable, and improving officer integrity. The reform aims to have more public trust in the DGT, more productive officer, and better tax compliance.

In general, the Modernization focuses on organization, business process, and human resources management.

This paper tries to take lessons from the current Indonesian Tax Administration Reform from the point of view of governance and portrays the governance process for the last ten years in Indonesian tax authority. The paper also aims to arouse the interest and hopefully help in provoking debate among academe, government officer, business people, and non-governmental organization's activists in seeing what really happened in the process of reforming tax administration in Indonesia.

As the DGT believes in reforming institutions and thereby changing incentives and implementing good governance practices, hence transparency, accountability and other elements of good governance have been increasing in the past ten years. Regardless some corruption cases, the DGT is truly a very different place than it was ten years ago. However, it still takes time to claim the success. The author believes that recent changes in the tax administration require more commitment on good governance from each stakeholder for the better future of Indonesian taxation.

## **1. WHY TAX ADMINISTRATION REFORM?**

The 1997 Asian crisis placed Indonesia into deep economic recession. Indonesia experienced serious crisis as the exchange rate plunged deeper, the banking system was damaged, and the GDP dropped. This was surprising, since few years earlier, the World Bank praised Indonesia as one of the East Asian Miracles.<sup>1</sup> Indonesia, at that time, had experienced 7% annual growth for three decades under the Soeharto administration in the so-called New Order Government. The enjoyment of high economic growth, however, ended, as the 1997 crisis deepened. Corruption and poor governance was one of the causes of the growing crisis, as summed up by Hill (1999: 47-83). Continuing corruption, collusion, and *népotisme* (*Korupsi*, *Kolusi* and *Nepotisme* or KKN in popular Indonesian terminology) that prevailed during the crisis worsened it. These factors, in conjunction with other factors such as the unstable international financial and capital market, macroeconomic

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<sup>1</sup> Krugman argues that it was not a miracle but a myth. He predicted that the growth would slow down following 'the law of diminishing return.' (See more on Krugman's "The Myth of Asia's Miracle." *Foreign Affairs*, November/December 1994).

policy weakness, domestic financial sector weaknesses, and IMF's failed recipe at the early stage of the crisis, worsened Indonesian economic crisis.

The crisis certainly has had impact on tax revenue, as the purchasing parity power of the society had decreased and some corporate taxpayers had liquidity or even solvency problem since the real value of their debt was in foreign currency denomination. This had created pressure to have more efficient tax administration in collecting tax revenue. The Government of Indonesia (GOI) has been promoting, as consequence, the tax administration operation is to carry out more transparently and fairer. In response, the DGT has launched the modernization program with three main objectives: to have high taxpayer compliance, high public trust in the Directorate General of Taxation (DGT), and high productivity of tax officers

In generating the capacities to implement tax administration reform towards good governance practices, the DGT has enjoyed an explicit and sustainable political commitment from the GOI regardless the change of the regime. A Tax Modernization Team with capable human resource, although not in a full time basis, runs the gradual comprehensive administration reform with a well-defined and appropriate strategies and programs.

According to the World Bank, Indonesia has a sound tax structure (2003b: ii). The World Bank also reported that Indonesia has a good tax system but a low tax ratio. The bank further assumed that the Indonesian low tax ratio might be partly due to Indonesia's reliance on oil and gas revenues. Given that the present structure of the tax system in Indonesia is fundamentally sound, after a major reform in the mid-1980s, therefore, the World Bank argued that future revenue growth would come mainly from improving a weak tax administration. It would also come from developing new and more efficient sources of revenue, including non-tax revenue, and better managing of the government's dependence on natural resource revenues.

Indonesia had a tax to GDP ratio<sup>2</sup> as much as 11.00% in 2001. This figure was much lower in comparison with neighboring countries such as Malaysia (20.17%), Singapore (22.44%), and Thailand (17.28%) in the same fiscal year (see Table 12.1). This low Indonesian tax ratio indicates the inefficiency of tax system and tax administration. It also indicates that there are some potential in the Indonesian tax system to be enhanced.

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<sup>2</sup> The tax to GDP ratio or tax ratio is simply defined as the ratio of taxes (revenues) to output. Judging tax ratio of a country and comparing to other's may mislead the conclusion since every country has their own characteristics such as political and economic structure, tax structure, income per capita, and public service capacity in general. However, a low tax ratio indicates an ineffective and inefficient administration.

**Table 12.1.** Tax Ratios of Selected Countries, 2001

Country	GDP (million USD\$)	Tax Ratio %
Singapore	84,900	22.44
Malaysia	88,000	20.17
Thailand	115,300	17.28
Philippines	71,400	13.69
Indonesia	168,428	11.00
Japan	4,100,000	13.50
USA	10,100,000	16.60
Myanmar	465,716	2.81
Pakistan	56,130	12.40
India	379,205	9.87
Mexico	467,345	12.00
Kuwait	3,708	3.00

Source: Tax Policy Team, MOF, 2003 and State Budget 2010.

Tax reforms have been conducted in Indonesia since 1980s. The first modern tax reform was crucially started in 1983 when Law No. 6/1983 on General Provision and Tax Procedures, Law No. 7/1983 on Income Tax, and Law No. 8/1983 on VAT and Sales Tax on Luxury Goods were launched. In this reform, Indonesia moved from official assessment to self-assessment system. It was a very important momentum for developing the taxation system in Indonesia, not only from a tax policy perspective but also from the standpoint of administration. This reform was aimed at improving tax collection and to change the colonial inheritance ordinances, to have more people's participation, to have good distribution of income, and to promote a self-reliant state budget. Many types of taxes inherited from the Dutch Colonial Government were simplified into four types: Income Tax, VAT and Sales Tax On Luxurious Goods, Land and Building Tax, and Stamp Duty. Following the reform, Indonesia experienced a sustained boom in tax revenue (Gillis, 1989: 105).<sup>3</sup>

<sup>3</sup> For a more comprehensive explanation on the reform during the 1980s, see Chapter 4 of Gillis (1989).

However, increasing tax revenue did not mean there were no obstacles. Tax noncompliance and corruption still hinder the effectiveness and efficiency of tax collection. Most Indonesians do not comply with their tax obligation, while tax corruption is pervasive and can seriously hurt the development. If the GOI expects to continue developing the economy, taxes are the only avenue for raising the needed revenues and the GOI has to deal seriously with those two problems; otherwise, the previous reforms will end up being no more than just examples of Indonesia's inability to overcome the inefficiency and malfeasance that have tainted so many tax collection efforts for decades (Prawiro, 1998).

According to Asher (1998: 138), tax compliance has always been a core issue in Indonesian tax reform. However, in practical sense, the main drive for reform has always been to increase the amount of tax revenue. At the initial stage of the 1980s' tax reform, the main concern of the GOI was the inefficiency of tax system, but then the concern shifted to how to increase tax revenue (Gillis, 1989: 91). It seems that the 1980s' tax reform was an anticipated response to the mid-1980s' economic crisis (Wardhana in Subiyantoro (ed.), 2004: 17) or as precautionary action for no longer reliable oil revenue (Prawiro, 1998: 238-239).<sup>4</sup> The 1980s' tax reform eliminated specific tax incentives, but the 1994's tax reform reintroduced them to encourage investment in the high priority economic sector. The 2000's tax reform was later introduced, in response to the economic crisis. Thus, the rationale of the previous reforms was more of a response to the crisis than the recognition of the capacity building process that emphasizes good governance practices and focus upon compliance. Although, the rationale for current reform is not so different in terms of generating tax revenue, the changes in political and social situation put more pressures on the GOI to change the tax system and administration.

Although previous reforms had always considered institutions and policies as the principal determinants of tax reform success, those reforms did not have good governance elements. Success in the policy and legal reform in the past, as part of tax institution and system, has not eliminated corruption within the DGT, nor has it changed the public's trust in the DGT. The Soeharto regime (1966-1998) focused on economic growth and disregarded the best practices in governance. Over three decades, the socio-economy and political development was based on a discretionary, corrup-

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<sup>4</sup> Both Wardhana and Prawiro were former Ministers of Finance under Soeharto Administration.

tion-ridden, and patrimonial system. Corruption, collusion and nepotism or KKN, has come to symbolize the social costs, inequities, and abuses of the Soeharto regime (Hamilton-Hart, 2001: 66), and has been also penetrating the DGT.

There was a growing pressure on the DGT to have another tax reform in 2001, although some new tax laws have been enacted a year before. The pressure came from the outside, i.e. the IMF through the MOF. The IMF had been giving assistance to the GOI/MOF/DGT since 1997. However, before 2001, the focus of IMF's assistance at the DGT was not specifically on good governance practices. The current tax reform is seen as necessary, in line with the spirit of reform in Indonesian bureaucracy.

In the meantime, enhancing democracy became a major agenda for the post Soeharto regime. This agenda promotes people's spirit to implement good governance practices in the public sector, including the DGT. Therefore, the role of the DGT, in a democratic Indonesia, has become more important, as societies need a modern democratic public administration including tax administration that will satisfy the public's requirements in the best possible manner. Therefore, the DGT must continually change and adjust itself to satisfy two requirements. It must be effective and efficient in collecting tax and providing tax services and law enforcement, and it must also satisfy the democratic requirements such as fairness, justice and transparent, and accountable. Thus, putting good governance elements into the tax reform, as a result, is a response of the DGT in supporting democratization process in Indonesia.

The current reform process initiated since 2001 is the fourth major tax reform after the 1980s. The reform was led by the DGT's Modernization Team, which received assistance from international donors. Learning from past reforms that disregarded good governance practices, the current reform incorporated good governance elements into the reform initiatives to create a more effective and efficient administration by making procedures more transparent, systems that are more accountable, and improving the officers' integrity. This current reform aims to have more public trust in the DGT, more productive officer, and better tax compliance. A new governance framework has been developed based on the principles of combating corruption, i.e. clear specification of the norms for acceptable and unacceptable behavior, an appropriate set of incentives and disincentives to encourage acceptable behavior, and creation of a mechanism for detecting and punishing violations of the norms.

The adoption of good governance is crucial for tax administration, yet there is no universal agreement as to how to measure good governance. Good governance is a normative concept and not easy to be measured. How to measure good governance is rather based on analytical frameworks that are also normative. Anyhow, efficiency and effectiveness can be seen as the quantitative aspects of good governance, while the others such as participation, transparency, and accountability are qualitative ones. Therefore, governance can be measured in terms of efforts or results.<sup>7</sup> As two main tasks of tax administration reform are achieving higher effectiveness or capacity to achieve high level of tax compliance, and efficiency or capacity to make administrative costs per unit of tax revenue as small as possible (Ott, 1998: 9-11). A tax administration is considered effective if there is a high tax compliance ratio, and it is efficient when the administrative cost ratio is low.

The reform continues. The GOI has launched the Indonesian Administration Reform Phase 2, which is well known as Project for Indonesian Tax Administration Reform (PINTAR). The project is led by the DGT's Team, which received assistance from the World Bank, the TAMF, Japan International Cooperation Agency (JICA), and other donors. The PINTAR focuses more on developing Information Technology, Management Information System and Human Resources Management Information System. Hopefully, the PINTAR will be finished in 2014 and can produce significant improvement to management and information system.

## **2. THE MODERNIZATION OF TAX ADMINISTRATION**

Implementing tax policy in an increasingly globalizes world is becoming more challenging for tax administrators, including the DGT. Recognizing this, the DGT has been modernizing its administration since 2001. In doing so, it established the Taxation Modernization Team with the help of international donors such as the IMF, AUSAID, CIDA, and JICA.

The current tax administration reform is well known as the Modernization of Tax Administration, later it is called the Tax Administration Reform Phase 1. Within the context of democracy and a more transparent society, the current reform draws much public attention. It has the element of public participation. The reform continues despite the many tax scandals involving tax officers and taxpayers as exposed by media and some concerned citizens.

## **2.1 The Objectives of the Modernization of Tax Administration**

The objectives of the Modernization of Tax Administration are to increase taxpayer compliance, to enlarge public trust in tax administration, and to improve the productivity of tax officer.<sup>5</sup> The soul of the reform is the implementation of good governance.

### ***2.1.1 Increasing Taxpayer Compliance***

The level of noncompliance in Indonesia is considered very high (see Nasucha, 2004 and Rizal, 2001). This high level of noncompliance is a very serious problem. It can reduce the needed resources to finance public services and increase the tax burden of those individuals and businesses who dutifully comply with the tax laws. However, it has never been easy to persuade citizen or taxpayer to voluntarily comply.

One of the modernization program's guiding principles for improving compliance is to make the tax system easy for taxpayers to comply with. According to the IMF, the current tax system poses major compliance burdens for taxpayers in terms of uncertainties in the laws and countless regulations, complex tax returns, excessive information reporting requirements, and poor taxpayer services (1998). These costs discourage voluntary compliance and, no doubt, have contributed significantly to the large numbers of taxpayers who, intentionally or unintentionally, fail to fulfill their tax obligations.

To improve taxpayer's compliance, the DGT has formulated and implemented strategies on program and activity which can keenly increase taxpayers' attentiveness and voluntary compliance, especially for the non-compliance taxpayer, for service improvement, higher compliant from the taxpayers' side, and effective law enforcement. The DGT also conducts tax awareness campaign as well as tax service development.

The modernization program also seeks to increase taxpayer compliance by strengthening the DGT's capacity to take enforcement action against noncompliant taxpayers. For a system based on self-assessment to be effective, taxpayers must believe that if they or their competitors fail to comply with their tax obligations, there is a reasonable chance that they will be caught. Once they are caught, sanctions will be imposed and are sufficient to offset the potential benefits of noncompliance.

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<sup>5</sup> See *Strategic Paper of the DGT*, Ministry of Finance Decree No. 85/KMK.03/2003. 2003/03/07.



### **2.1.2 Increasing Public Trust in Tax Administration**

Based on the research by the Partnership for Governance Reform (2001), many taxpayers in Indonesia have little confidence in the fairness of tax administration because they see themselves as vulnerable to arbitrary actions of tax officers. They do not have recourses to dispute a resolution system that is fast, low cost, and impartial. Faced with this situation, taxpayers find it more practical and less risky to collude with tax officers instead of declaring what is owed under the law. This eventually results in loss of revenue for the government and loss of integrity for the tax administration.<sup>6</sup>

In year 2003, Consumer News Magazine, published by Indonesian Consumer Foundation (*Yayasan Lembaga Konsumen Indonesia/YLKI*), questioned 2,236 consumers on why they do not want to pay taxes. 41% of the consumers answered that they do not believe that taxes they paid would return to them (or benefit them).<sup>7</sup> For gaining trust from taxpayer, Prof. Boediharjo suggested that the DGT should change its image towards a more friendly and pleasing organization to taxpayers. The Corruption Eradication Commission/*Komisi Pemberantasan Korupsi (CEC/KPK)* Chairman, Taufiqurrahman Ruqi, suggested the DGT to curb corruption by improving the system and not merely by punishing the small corrupt tax officers.<sup>8</sup>

Anwar (2006) indicates that public perception on the DGT was built on arrogance and absolute authoritarianism, excessive riches, and bureaucratic mentality that the tax officers possess. The perception of tax officers' arrogance was developed from the bad experiences of taxpayers or tax consultants in dealing with tax officers. The perception on excessive wealth possessed by the tax officers is based on what the public observe and see in daily life. This perception is developed base on the assumption that tax officer has a total property value that is impossible to earn in their lifetime

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<sup>6</sup> At Seminar on the DGT Reform toward Good Governance at Nikko Hotel, Jakarta 2006/02/04, Mas Achmad Daniry, the Chairman of Good Corporate Governance Committee of ICCI, argued that the main problem of Indonesian taxation is the distrust between taxpayer and tax officer. While tycoon Mochtar Riady confessed that he ever cheated in paying taxes because the tax officer did not trust his truthful return ("Due to Distrust, Businessmen Cheat on Paying Taxes," *Media Indonesia Newspaper*. 2004/ 8/31).

<sup>7</sup> Indah Suksmaningsih, the Chairman of Indonesian Consumer Foundation (YLKI) on *Transparency of the DGT: as Enhancement of Good Governance*. p. 162.

<sup>8</sup> Prof. Boediharjo, the Chairman of Rector Forum and Chairman Ruqi share their view on *Transparency of the DGT: as Enhancement of Good Governance*. 2005.

work. Bureaucratic mentality, which is commonly found in civil service, has emerged due to conceited attitude of being a state official not a civil servant.

To improve this situation, the modernization program also aims at restoring the taxpayers' trust in tax administration. The modernization program's main strategies include image enhancement of the DGT in the eyes of the public and adoption of the pilot project offices as a model to the rest of the administration. To improve its image, the DGT tries to amend the tax laws, to implement good governance framework, to improve objection and appeal mechanism, and to improve audit procedure.

### ***2.1.3 Increasing the Productivity of Tax Officer***

To increase tax officer's productivity, the medium-term modernization program seeks to establish a quality work environment that promotes high performance and accountability for results. This productivity improvement has been a recurrent theme of tax reform. Currently, this issue involves motivating, training, compensating, and also overseeing tax officer. A common problem is the provision of adequate and competitive compensation structure. However, since remuneration is generally governed by budgetary constraints and general rule of civil service, other approach has been adopted such as provision of the Additional Financial Allowances.

To accomplish this third goal, the DGT has been conducting a program on improving the organizational structure that covers reorganization, improvement on monitoring capacity and superior's guidance, formulation of new human resource management policy, and improvement in working facility and infrastructure.

## **2.2 What Areas Being Reformed?**

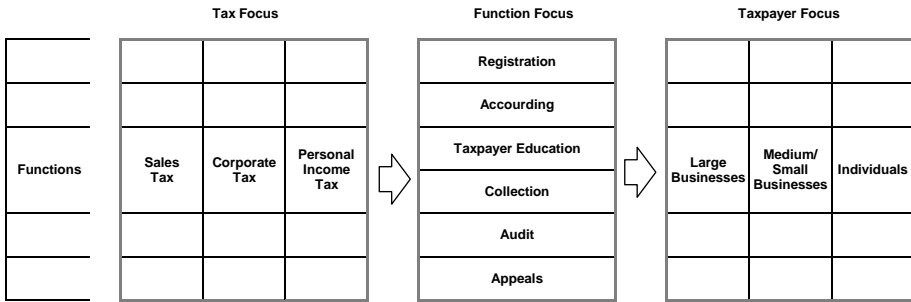
Since 2001 the GOI has been gradually implementing tax administration reform initiatives to strengthen tax collection and to improve the governance of tax administration. In general, the modernization focuses on (a) organization; (b) business process; and (c) human resources management.

### ***2.2.1 Organization***

To catch up with the development of business sector and to adapt with changing environment, the DGT has to innovate and do continuous improvement in its organization. The DGT has been shifting from type of

tax-based organization structure into functional based organization structure (see Figure 12.1).

**Figure 12.1.** The Evolution of Organizational Design Ideas for Tax Administration



Source: Ebrill, Keen, Bodin, and Summers (2002: 135) as cited by McCarten (2003).

The DGT has realized that the type of tax-based organization resulted in inefficiency, through duplication of functions (see also Rizal, 2001). Moreover, the functional-based organization is characterized by grouping the staff based on essential administrative functions such as processing tax returns and payments, audit, and arrears collection.

The reorganization began with the establishment of large taxpayer units mainly driven by the presence of the IMF.<sup>9</sup> In this initiative, the tax service offices, tax audit offices and land and building tax offices were liquidated and the service is handled by Large Taxpayer Office (LTO), Medium Taxpayer Office (MTO) and Small Taxpayer Office (STO) which is dependent upon the contribution and the size of the taxpayers.

In new modern tax offices, taxpayer’s compliance is monitored and evaluated by Account Representatives (AR), a new position to serve taxpayers with the help of the advanced information technology. The company profile of each taxpayer is utilized to gain more knowledge of taxpayer’s business. In detail, the functions of AR are to develop and maintain taxpayers profile and data, to supply data to other units, to give ruling and counseling service, to monitor tax return, to monitor taxpayers’ compliance

<sup>9</sup> Many of the 40 countries surveyed in the IMF’s study reported that the setting up of a large taxpayer unit helped them address major operational weaknesses in tax administration and to visibly improve core tax administration functions (Baer, Katherine *et al.* 2002)

and analyze the service, to monitor tax revenue collection, and to process tax refund claim.

This initiative is intended to achieve a quantum improvement in the performance of the DGT by substantially strengthening taxpayer services and enforcement program, customizing them to the circumstances of small and medium taxpayers, and establishing greater accountability of managers and tax officers. The foundation of the segmentation of taxpayers is based on the premise that different groups of taxpayers have different needs of services and pose different risks of noncompliance. The reorganization into modern tax offices was completed at the end of 2008.

### **2.2.2 Business Process**

In the reform of tax administration the importance of tax structure is clearly reflected, because tax administration and tax structure are interconnected and they have to be improved simultaneously in the tax reforms (The World Bank, 1991). Simplification of rules and procedure is an important way to increase the effectiveness and efficiency of the tax administration business process. For example, a simple tax forms and filing procedure can minimize both administration cost and taxpayer compliance cost.

The transformation of business process is a key pillar of the strategy in modernizing the operations of the DGT. This will make the tax system easier for the taxpayers to comply with and for the tax officers to administer. The transformation of business process is also closely related to the utilization of adequate and appropriate IT. For organizational strengthening, particularly in the decision support system, IT is a very important key factor. Without IT improvement, innovation in business sector will never be caught up by the DGT. Moreover, the utilization of adequate IT will enhance transparency and minimize misconducts and abuse.

In fulfilling its ambition to become a modern ‘world-class’ tax administration, utilization of IT to support the DGT operations is indispensable. The IT, combined with such communications technologies as the Internet, enables citizens to self-register, download forms and regulations, etc. This initiative is also popularly called “e-government reform.” The e-government system may lead to greater transparency, accountability, and reduce administrative corruption. As a result of this initiative, tax offices are brought closer to the public, so that the public can see clearly the daily operations of the DGT.

To modernize and improve operations through increased use of IT applications, the DGT has developed the DGT Information System. The DGT has also developed the e-SPT (e-filing) and e-payment systems. E-SPT is a software application to facilitate taxpayers reporting of their tax returns. The e-payment has been designated as excellent services to taxpayers and immense importance to having timely tax revenue as well as improving the DGT performance, transparency and accountability. Due to the lack of capacity, the DGT outsourced some of the system development job to external resource/vendors. A set of web pages has been also provided as incentives to third parties to increase e-filing, in addition to providing electronic customer account management capabilities. The DGT has also developed the Data Processing Center that gathers data from tax returns, tax payments, and third-party reports.

### ***2.2.3 Human Resources Management***

The initiatives to develop human resources seek to increase the capacity of individuals to carry out their duties and, ultimately, will result in higher productivity, tax compliance and higher public trust in the DGT. Reform in human resource is critical to achieving sustainable performance improvements. To strengthen the capacity of officers inherently requires fundamental changes in their behavior. This includes officers' sense of vision, mission, and goal, desire to work effectively and efficiently, and commitment to integrity and best taxpayer service.

The present demands and expectations concerning the performance of the DGT staff are high and will be much higher in the future. In this regard, there is a high need for a competent and skilled workforce with multifunctional talents. There will be less demand for low skilled officers, as expectations and performance become more complex. It is very important also to develop disciplined and efficient offices with good human relations. In this context, to improve voluntary compliance on the part of taxpayers, the DGT should act in fair and impartial way. Taxpayers will find it easier to be approached by the DGT if it has combined right attitudes with best performance.

To increase the capacity of human resources, the DGT has introduced the reform on human resources management policies including modern office staff selection procedures, the creation of special allowance, and training in tax management and procedures for new and existing tax officer. It also includes formulation of a comprehensive set of performance evalua-

tion measures, establishment of new job classification system, introduction of a new appraisal system, and setting up the sustainable new compensation system.

### **2.3 Issues on Good Governance**

The issue of corruption is a high concern and the GOI and the DGT recognize the serious effects on tax revenue of such behavior have to the business community and foreign investment. As a capacity building initiative, the tax administration reform helps the DGT in curbing corruption in the DGT. Eventually, professional tax officer with integrity will enhance productivity, tax compliance, and improving the image of the DGT in the eyes of public.

Good governance exists where the DGT is perceived to have acquired this power legitimately, and there is appropriate voice accorded to those whose interests are affected by decisions. Good governance should result in performance that is responsive to the interests of taxpayers and other stakeholders. In addition, good governance cannot be said to prevail unless there is genuine accountability at play between the DGT as the agent and the GOI as the principal. Accountability cannot be effective unless there is transparency and openness in the conduct of the organization's work. Finally, governance should be fair, which implies conformity to the rule of law and principles of equity. The failure of the DGT's program in trying to push for more accountability within the DGT might cause no change in public trust in the DGT.

As a part of its tax administration reform strategy, the GOI has prepared a governance framework aimed at promoting transparency in tax administration and integrity among tax officers. The good governance initiatives implemented by the DGT includes the establishment of governance unit, code of conduct (COC), e-government, complaint centre, and a telephone hotline for large taxpayers to report the misconduct of tax officers. Meanwhile, the MOF has established the Investigation Unit of the Inspectorate General and Commission on Taxation Monitoring.

### **3. LESSONS FROM INDONESIAN TAX ADMINISTRATION REFORM**

Almost ten years have passed after the DGT launched the reform with a new paradigm involving good governance elements. Reforms need time and results always depend on the criteria underlying the evaluation. However, some lessons can be drawn from the Indonesian experience with the current tax administration reform.

#### **3.1 Effectiveness and Efficiency of Tax Administration**

In general, if we compare the effects of current reform on tax compliance with the previous ones, we can see that there have been few improvements except for improving the collection of tax arrears. In contrast, tax revenue has increased remarkably. In the middle of the current economic slumps, simply making changes in tax structure, such as raising all tax rates or broadening tax base as previous reforms did, would not be effective due to the high tax gaps. Further, an increase in tax revenue may come from sustainable administration reform that can overcome the present shortcomings such as inadequate legislation, poor organization, inefficient human resources, and corruption.

##### ***3.1.1 Effectiveness***

**Tax Revenue.** Since the 1980s tax reform, the watchwords have been the accomplishment of tax revenue target through improvement on three pillars: service, counseling and audit. However, in addition to internal factors, tax revenue also depends on external factors over which the DGT has no control. The tax base of Income tax, VAT and import duties depends on the impact of general economic trends. Furthermore, the tax culture is affected by the quality of public services and infrastructure provided by other government agencies. Therefore, it is remarkable that during the economic recovery after 1997, the DGT could achieve the tax revenue target no matter how high it was up to 2008. This suggests that the operation of DGT has become more effective and efficient.

Up to 2008, the reform is a success in terms of meeting tax revenue targets. As we can see in Table 2, tax revenue growth was 73.4%, 10.6%, 9.8%, 12.5%, 20.5%, 20.4%, 18.3%, and 25.3% from year 2001 to 2008, respectively. On average, the growth of tax revenue is 23.9% from 2001 to

2008. The contribution of tax revenue was more than 75% of the state revenue in 2008 and the tax ratio rose from 11.9% in 2000 to 13.3% in 2008.

The increased tax revenues for the period 2001-2008 was also influenced by the improvement in macroeconomic situation and the prudent management of monetary and fiscal policy. The GDP had been growing but still below the pre-crisis growth, which was 7% in average. To date, Indonesia's overall macroeconomic picture is stable and improving. The GOI has succeeded in pushing forward its reform plan, including tax reform.



**Table 12.2.** Tax Revenues 1989/1999-2008 (in billions Of rupiah)

Fiscal Year	VAT	Income Tax	Excises	Property Tax	Other Taxes	Import Duties	Export Tax	Total	GDP <sup>3)</sup>	Ratio (%)
FYP V										
1989/90	5.986,10	5.754,80	1.482,20	604,4	191,1	1.892,20	173,30	16.084,10	148.101,8	10.9
1990/91	8.119,20	8.250,00	1.799,80	785,8	216,5	2.799,80	39,80	22.010,90	172.840,3	12.7
1991/92	9.145,90	9.727,00	1.915,00	944,4	298,8	2.871,10	17,10	24.919,30	200.702,1	12.4
1992/93	10.742,30	12.516,30	2.241,60	1.106,80	252,4	3.223,30	8,80	30.091,50	236.644,4	12.7
1993/94	13.943,50	14.758,90	2.625,80	1.484,50	283,4	3.555,30	13,70	36.665,10	308.184,4	11.9
FYP VI										
1994/95	16.544,80	18.764,10	3.153,30	1.647,30	301,9	3.900,10	130,60	44.442,10	365.750,9	12.2
1995/96	18.519,40	21.012,00	3.592,70	1.893,90	452,8	3.029,40	186,10	48.686,30	433.110,4	11.2
1996/97	20.351,20	27.062,10	4.262,80	2.413,20	590,7	2.578,90	81,00	57.339,90	511.365,4	11.2
1997/98	25.198,80	34.388,30	5.101,20	2.640,90	477,8	2.998,70	128,50	70.934,20	633.520,5	11.2
1998/99	27.803,20	55.944,30	7.732,90	3.565,30	413	2.305,60	4.630,20	102.394,40	947.659,8	10.8
1999/00	33.087,00	72.729,00	10.381,20	4.107,30	610,9	4.177,00	858,60	125.951,00	1.138.115,8	11.1

(continued)

**Table 12.2.** Tax Revenues 1989/1999-2008 (*continued*)

2000	35.231,80	57.073,00	11.286,60	4.456,10	836,7	6.697,10	331,20	115.912,50	971.502,6	11,9
2001	55.957,00	94.576,00	17.394,10	6.662,90	1.383,90	9.025,80	541,20	185.540,90	1.684.280,0	11,0
2002	65.153,00	101.873,50	23.188,60	7.827,70	1.469,30	10.344,40	231,00	210.087,50	1.863.275,0	11,3
2003	77.081,50	115.015,60	26.277,20	10.905,30	1.654,30	10.884,60	229,70	242.048,20	2.045.853,0	11,8
2004	102.572,70	119.514,50	29.172,50	14.685,20	1.872,10	12.444,00	297,80	280.558,80	2.303.031,0	12,2
2005	101.295,80	175.541,20	33.256,20	19.648,60	2.050,20	14.920,90	318,20	347.031,10	2.774.281,1	12,5
2006	123.035,90	208.833,10	37.772,10	24.043,00	2.287,40	12.140,40	1.091,10	409.203,00	3.339.216,8	12,3
2007	154.526,80	238.431,00	44.679,50	29.658,90	2.737,70	16.699,40	4.237,40	490.988,70	3.950.893,2	12,4
2008	209.647,40	327.497,70	51.251,80	30.927,40	3.034,40	22.763,80	13.578,30	658.700,80	4.951.356,7	13,3

Source: Financial Notes and Budget.

**Notes:**

- 1) Since Fiscal Year (FY) 1999/2000 including Income Tax on Oil and Gas.
- 2) Since FY 1998/1999 including Duty on Land and Building Transfer.
- 3) Since FY 1989/1990 - 1998/1999 GDP Non Oil, FY 1999/2000 - 2006 Total GDP.
- 4) Period from April 1st to December 31st, 2000 (9 months).
- 5) Adjusted to new classification.

In addition to the national economic condition, the highest tax revenue performance in 2008 also attributed to the high global oil price and the taxpayers' positive response on Sunset Policy. Still, tax revenue remains low at 72% in average. In countries with more fully developed tax system, the tax potential could be 80-85% (Gitte, 1993: 6). The tax ratio is still relatively low in comparison to other Asian countries. It was also lower in comparison to the 14% in average tax ratio of Latin American Countries. In developed countries, the tax ratio could be 40% or more (Musgrave and Musgrave 1980: 332-333). Among ASEAN countries, Singapore had the highest ratio, 22.4%. The average ratio for the original five ASEAN countries was 16.98%, while the Indonesian tax ratio was only 11.31% from 1985 to 1995 (Rizal, 2001: 4).

On the other hand, since the crisis, Indonesia's economic growth has by and large relied on consumption, government consumption in particular (The World Bank, 2003a: 2). In addition to successful simplification administration of VAT, the significant increase ratio of VAT happened due to removal of some tax facilities such as tax exemption and the government-borne VAT for specific goods and services, which were previously granted by 1994's reform.

Tax Compliance. The current reform has led on the improvement in the number of registered taxpayers. The number of registered taxpayers increased significantly from 2.52 million in 2001 to 3.69 million in 2004. Of that number, 2.63 million were individual taxpayers and 1.06 million were corporate taxpayers in 2004. The figure for registered individual taxpayers was still very low in comparison with 93.72 million workers (National Labor Survey, 2004). In countries such as Indonesia, where the underground economy is big at 19.4% (Schneider, 2004: 8),<sup>10</sup> the number of unregistered taxpayer is also big.

In 2005, the DGT launched a crash program on 10 million of Tax Identification Number (TIN). Instead of waiting for the people to voluntarily register themselves as income taxpayers, the DGT has been aggressively mapping potential taxpayers who remain outside the tax net through their property and car ownership, credit cards, citizen registration and other financial transactions. And based on this data, millions of new taxpayer registration numbers have thus far been officially issued and mailed to

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<sup>10</sup> Schneider, Friedrich. 2004. Shadow Economies of 145 Countries All Over the World: Estimation Results over the Period 1999 to 2003. <http://www.dur.ac.uk/john.ashworth/EPCS/Papers/Schneider.pdf>

taxpayers resulting in additional registered taxpayer as much of 6.3 million taxpayers within one year (October 2004-October 2005) by official registration.<sup>11</sup> By this program the number of Individual and corporate taxpayers increased into 9,785,511 and 1,134,559, respectively.

Sunset policy, the softest type of tax amnesty that granted by the GOI to noncompliant in 2008 also contributed to the increasing number of individual taxpayers. The results of Sunset Policy are the increasing number of taxpayers as much of 5,365,128 and the increasing tax revenue as much of Rp7.46 trillion. The policy is to provide to individual who voluntarily registers to get TIN during Sunset Policy period and submit 2006 and previous year's tax return and to individual and corporate taxpayers who revise their 2006 and previous years' tax return during Sunset Policy period.

As of January 1 2009, the number of taxpayers was 15,469,590, which consists of 13,861,253 individual taxpayers and 1,608,337 corporate taxpayers. Yet, the filing compliance has not improved significantly, as the number of registered taxpayers who stopped filing their return is increasing. The filing gap ranged from 65% to 62% between 2004 and 2005 (DGT 2005, 2004), and 65% to 58% between 2000 and 2002 (Nasucha, 2004: 11). As of January 2009, the ratio of stop filer is approximately 47.39%. Apparently, the DGT has dealt systematically with stopfilers, taxpayers who stop filling their tax return.

Among the effective registered taxpayers, not all of them report their taxes correctly as reflected in the result of the tax audit showing many audited taxpayers substantially under-reporting their tax base year by year. 65% of the audit performed was refund claim-audits.<sup>12</sup> The productivity of tax auditor is also low as there were 44,278 (35%) incomplete audits in 2004. This low productivity is an obstacle to tax realization.

Of tax arrears, some tax bearers do not have good intention to pay tax arrears even they have capacity to fulfill their obligation. There are various ways to avoid paying tax arrears committed by taxpayer, i.e. liquidating the company or filing bankruptcy, changing the company's management, share-

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<sup>11</sup> See also 2005 Minister of Finance's Report. According to this report, this was due to extensification program after cross checking process between DTI data and National Master File. The data for cross-checking came from land and building ownership, luxurious car ownership, luxurious boat ownership, residential data and others. (Anwar 2005).

<sup>12</sup> The tax audit performed by the DGT is not effective since it focused too much on the refund audit as stipulated by the legal requirement that all refund claims had to be audited regardless of the reliability of the refund claimants. Therefore, nonproductive audits are performed every year, which also worsened compliance level in paying the tax due and increasing tax arrears.

holder, or board of directors, etc., which effects in changing the tax bearer, or transferring company's assets to another company. The tax arrears with more than 5 years constitute more than 40% of total national tax arrears in 2008. With annual inflation rates of 6-7% or more during the period, the revenue loss in real terms can be substantial.

### **3.1.2 Efficiency**

For the tax revenues during the current reform, the collection cost is perceived to be low. For example, only 0.33% was needed for each rupiah collected in 2001, 0.58% in 2002, and 0.56 % in 2008 (see Table 12.3). This collection cost is low in comparison with the 2.0% figure of developed countries.<sup>13</sup> Before the reform, these figures may be biased, since some operations were financed by either individual money or off-budget funds. In the past, the utilization of tactical budget might have helped the DGT lowering the costs of collection but this is against good governance practices.

The dynamics of tax administration reform makes the needs of operational fund increasing. The fund is not only used for human resources training and incentives, but also infrastructure development and maintenance, IT development, and reorganization. From the table below, there was almost double leap of the expense in year 2002, in comparison with the expense in year 2001, due to increasing on modernization cost. Gradually, with the effect of modernization, this collection cost decreased with the simplicity of the tax law and more effective administration. Part of this administration cost can be shifted to taxpayer as compliance cost through legal and procedures.

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<sup>13</sup> In 2000, when Indonesian COTCR was 0.34%, Japan was 2.40%, Taiwan was 1.57%, Hong Kong was 1.31% and Singapore was 0.95% (DGT 2005: 33).

**Table 12.3.** Cost of Tax Collection Ratio

Year	Routine Expense (trillion rupiah)	Tax Revenue adm. by the DGT (trillion rupiah)	Ratio
2001	0.52	158.58	0.33%
2002	1.03	176.32	0.58%
2003	0.93	204.66	0.45%
2004	1.08	238.98	0.45%
2005	1.31	298.34	0.44%
2006	1.43	358.05	0.40%
2007	2.41	426.23	0.57%
2008	3.21	571.10	0.56%

Source: DGT Reports. 2009.

### 3.2 Good Governance Practices

The difference between the current reforms with previous reforms is found in the implementation of good governance. However, does this mean that clean institution considerations matter in reforming the DGT? The answer to this question is “yes,” since to a certain extent, the goal of having clean government has been redefined and transformed into having good governed institution to make the DGT a world-class tax authority. However, there also seems to be increasing acceptance of the notion that the DGT, as an institution, may play rhetorical game and not serious with the reform. The goals of tax reform may be utopian due to the intertwined relationships among government institutions and ties among three development actors as corruption is hampered. Moreover, the DGT also has to keep equilibrium between the main stakeholders’ desires. The GOI, in general, wants tax laws that can encourage investment and help in restoring the economy, the taxpayers/public want a business-friendly and clear tax laws with minimal discretion for tax officers, while the DGT wants an effective tax laws that can enhance taxpayer compliance and tax revenue.

Good governance is at the top of the DGT agenda. Many programs have been conducted. However, the question remains “why corruption still exists?” Attitudes have changed so dramatically not because of internal good governance framework but because of fear towards the CEC/KPK. Officers are quite aware there are fewer opportunities for bribery and taxpayers are also afraid of being trapped. Ultimately, the taxpayers and other citizens may

also suffer from corruptible justice system, which has institutionally collapsed.<sup>14</sup>

Ten years have passed since the DGT started its efforts to combat corruption. Some officers call the efforts naive and hypocrisy when the Gayus Tambunan case exploded in March 2010. It is not that the negative consequences of corruption are unknown, but rather, those who live under conditions of endemic corruption tend to be fatalistic, believing that the problem is simply too big to solve, or people is already engaged in social anime. The good governance initiatives are perceived as weak due to the difficulty in breaking the old habits.

### **3.3 The Good Governance Elements in Practice**

The good governance of the modernization program emphasizes transparency and accountability. Participation and equity have become the content of the initiative in line with the increasing participatory of stakeholders and demand on equity from taxpayers. Meanwhile, effectiveness and efficiency have already been part of tax administration reform for long.

#### **3.3.1 Participation**

The vital role of the DGT and tax revenue for sustained economic growth and sustainable development financing underscore the need to introduce and sustain participatory processes in overseeing the operation of the DGT and processes of tax law making. Participation from all stakeholders, especially by the taxpayers in the accountability processes of tax administration, is critical to the timely and full realization of the good governance framework implemented by the DGT. Understanding what is needed to improve such processes and institutionalizing reform in the laws, regulations, and practices of decision making is the goal of the enhancement of participation in tax reform. This means engaging all stakeholders including the GOI/MOF, tax officer, business actors, civil society organizations, and the least disadvantaged in the decision-making processes through participation in policy formulation, implementation, monitoring and review. In this context, tax law drafting is one of the entry points for civil society participation.

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<sup>14</sup> Sebastiaan Pompe (2005) discussed comprehensively the collapse of Indonesian judicial system in his book “*The Indonesian Supreme Court: A study of Institutional Collapse.*”

There is considerable difference between the current reform and the previous one, particularly the 1980s reform, in the aspect of participation. The current reform follows the process in formulating and approving the law that is stipulated by the Presidential Instruction (INPRES) No. 15/1970,<sup>15</sup> while the 1980's reform ignored it. This is due to the adoption of a low-key approach in the 1980's reform by the GOI. According to Gitte Heij (2001), this approach was adopted with the impossibility of the hired foreign adviser to be on the ground but liaised with the resident consultants and the MOF bureaucrats.<sup>16</sup> Therefore, there was no public discussion and the foreign economists involved in the tax reform team agreed with this strategy. They believed such discussion would only complicate the task and increase the risk of producing simple tax laws due to the possibility of groups lobbying for particular tax incentives. A similar thing happened to other previous reforms (1990s and 2000). It is understandable since the role of government was quite strong particularly in the 1994 reform when President Soeharto was in power.

The situation has been quite different in the "Reformation Era." The desire to participate in every policy decision making is high; there is demand for transparency, including in taxation area. The participation of the business association and other parties in drafting the tax laws was not minimal but significant. Such enthusiasm and active participation required more time in drafting the new tax law. Obviously, the benefit of encouraging participation is that it helps provide reliable information concerning taxpayers/public interests. In the end, the draft did not only accommodate this group but also

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<sup>15</sup> The process for formulating and approving a law is as follows:

- The department seeks to have President's approval for preparing a law in relevant policy area;
- Following the approval, the initiating department forms an inter-departmental team to prepare the law. At this stage, the private sector might be involved in the preparation of the law up to certain point of the process;
- After having clearance from the Cabinet Secretariat and approval from the President, the draft is sent through the State Secretariat to the parliament. At this stage, public participation is possible in the forms of hearing;
- After adopted by the DPR, the GOI has to formulate the necessary implementing regulation. (Rohdewohld, 1995: 46-47).

<sup>16</sup> Williamson was in charge of the specific legal issues and Malcom Gillis for the main part of the work. The Harvard Institute for International Development (HIID) experts worked on a 'fly-in fly-out' basis, and were often in Indonesia no longer than one or two weeks to assess the situation, mainly in the period between 1981–83. In most cases, Gillis summarized the advice from the various foreign advisers and sent the summaries to the Minister of Finance Wardhana and DG Salamun.



the interests of the GOI and the DGT. Though certainly, there are some parts that did not satisfy each party.

Another form of participation is monitoring the day-to-day operation of the DGT. The mass media, nongovernmental organizations, most notably the Transparency International chapter Indonesia and Indonesian Corruption Watch, the business sector, such as the Indonesian Chamber of Commerce and Industry, the Indonesian Tax Consultant Association, and the academe continuously criticize the DGT for bribery practices. This, however, has helped significantly in promoting action against corruption in the DGT.

The DGT itself can also participate in curbing external corruption by issuing tax treatment on bribes and following up the Financial Transactions Report and Analysis Center (PPATK) and other third party tax crime data. It is necessary for the DGT to create follow-up procedures that allow monitoring in the implementation of minimal standards and in reviewing the instruments at regular intervals. Both aspects are crucial for further development since corrupt people will seek new ways to continue to bribe.

Within an interconnected world, an effort to curb corruption will not be independent from other parties' role. It is a part of a triangle in good governance that includes governments, particularly a reformed DGT, taxpayer (business sector), and the civil society organizations. In reforming the DGT, however, it is still not aware that the media and civil society organizations could be the closest allies or the strongest partners. Without the media, the DGT would be practically helpless in its attempt to change its image from one of the most corrupted institutions into a good governed one.

Citizens, as another stakeholder, also play important role in monitoring the DGT's day-to-day operation and tax officer's good governance practices. To enhance citizen participation, it is necessary for the DGT to develop and improve access to information so that there would be an improvement in public service and reduction on opportunities for corruption. For this end also, it is necessary to establish a citizens' information center to provide general guidance on how to access the DGT services and support the DGT's good governance framework. However, this process takes time since it evolves in the relationship of promises and actual performance. It also requires building new relationships among stakeholders.

### **3.3.2 Transparency**

Transparency is widely viewed as a necessary condition for effective corruption control and, more generally, for good governance. Lack of transparency is likely to result in public or taxpayer ignorance. On the other hand, transparency has limitation. For example, in case of law enforcement, the DGT has to keep operating in secret to such extent to protect taxpayer's rights.

To date, the DGT already has specific programs to put an end to corruption within the organization, such as the implementation of COC and establishment of the governance unit. Also, in regard to the fight against corruption, echelon 2s, heads of tax office and tax auditors have been being obligated to disclose their wealth and report it to the CEC/KPK. However, the existing anti-corruption measures require more efficient and transparent accountability, and guarantees for taxpayers to have access to information on governance of the DGT. More importantly, the goodwill of the leaders to implement the existing anti-corruption measures is necessary for more consistency and transparency.

There is great human potential and environment for change and progress in the DGT today. This will enable the DGT to overcome the problems of corruption. Today, both taxpayers and tax officers are witnesses of the progressive adoption of the culture of transparency. This has undoubtedly been a powerful incentive to restore the trust that should exist between those who are governing and those who are governed. Likewise, transparency is aimed to correct any distortions in the exercise of public functions of the DGT including corruption practices.

The DGT tax officers operate in a changing world where the nameless and faceless tax officer is becoming a relic of the past. Greater transparency in the DGT operations due to public access to official information, coupled with the efforts of an increasingly zealous media and well-organized interest groups, means that tax officers today work in a virtual aquarium. Their actions are more visible and publicized as well as their mistakes and misbehaviors. They face higher public expectations on the quality of tax services and their capacity to deliver them. If these conducts are not met, the result is taxpayer's dissatisfaction.

The openness and transparency of the new DGT will open the way to improvements in good governance. Although it is still in the infant stage much has to be done first, the progress can already be seen such as the ongoing legislation of the new tax law. Meanwhile, there have been real and

significant changes in the way the modern tax offices operate over the past few years including in enhancing transparency and communication with taxpayers and other stakeholders and expanding channels for participatory processes due to dissemination of reliable information to the taxpayers. Substantial benefits were also derived from greater transparency through e-government provided by the DGT.

### **3.3.3 Accountability**

Accountability means tax officers need to account for their actions and, in consequences, there is certain punishment when officers commit misconduct. The concept of accountability is changing, with tax officer being more visibly responsible for their duty to perform the task. Targeting outputs for officers or field offices may induce managers to be more efficient in performing their task. If they lack discretion in their resources but are accountable in terms of good governance means that the manager is required to maintain the taxpayers' and other stakeholders' interest.

The DGT has created a new government and citizen interface by implementing IT or e-government initiative. The initiative eventually led to a more transparent, interactive, and accountable tax administration. Using e-government, taxpayers are able to fulfill their tax obligation without direct contact with tax officers. When people are already aware that tax is vital for the country's development, they may object to the methods by which tax is obliged and collected. Therefore, e-government may improve accountability and the extension of tax base and collection methods rather in addition to law enforcement.

With regards to efficiency, accountability contributes to efficiency in two ways. First, by targeting outputs, tax officer can be responsible for the volume, timeliness, and quality of the tax services produced. Second, by giving tax officer full discretion, they can apply their professional skills, judgment, and information to select the most efficient mix of inputs. Accountability also contributes to the rule of law and equity in monitoring the conduct of tax officer and continuous education on good governance practices to curb corruption.

Unlike corruption in other public sector, which is more on procurement activity, corruption in the DGT mostly occurs as tax extortion and bribery due to the characteristic of tax service. It consists of monopoly and huge discretion and less accountability. This is in line with Klittgaard's famous formula, "Corruption = Monopoly + Discretion – Accountability"

(1988). The aspect of accountability that should be considered here is feedback and feed forward. Taking into account the audit reports of the IG or other oversights, they are useful in improving or strengthening or promoting accountability.

Based on Article No. 36A of Law Number 6/1983 as amended by Law Number 16/2000 on KUP, a tax officer who committed misconduct shall be punished according to the applicable laws. The applicable laws for internal law enforcement are Government Regulation (GR) No. 30/1980, GR No. 32/1979 and GR. No. 6/1979 and, GR No. 6/1966 on Civil Servant Dismissal, and Minister of Finance Decree No. 15/1985. The DGT has punished more than 2,000 officers on the basis of these regulations to enhance accountability practices from 2001 to 2008. The punishment varies from the statement of unsatisfactory performance to discharge with dishonor.

### ***3.3.4 Rule of Law***

Some taxpayers believed that the legal framework of taxation is not enforced impartially because of corruptible officer. In a non-democratic regime, tax payment can be easily evaded, even defied, and this represents political influence of top elites. At macro level, cronies have immunity from law and impunity of violation. This has made the DGT and other law enforcer reserved and reluctant to work for change. Therefore, tax evasion has become a highly profitable business in which both the tax evaders and tax officers share the benefits.

As far as the rule of law in taxation is concerned, the prime responsibility is in the hands of the tax officer. When it becomes tax crime, the DGT cannot act alone. It has to collaborate with police or prosecutor. Through constant interaction with police and prosecutor as an institution, not in individual cases, law enforcers can collaborate instead of being isolated and ineffective or only partially effective, and the alliance would deter law-breakers and infuse morale among honest tax officers.

Yet, there are important preconditions for the successful implementation of good governance elements, and these should not be ignored by the DGT, which is striving to improve its image. In addition to improvement on remuneration system, a reliable control is needed, either internal or external controls. There are two elements for effective controls systems, namely, workable rules and procedures, and patterns of behavior that accept the rules and procedures as legitimate.

The taxpayer and tax officer are respected equally by the rule of law. It also allows the DGT and taxpayer to resolve disputes in a rational way. The DGT can gain respect from the taxpayers if it can utilize its regulatory capacity to establish and enforce the rule of law internally and externally. By the rule of law, there should be no exceptions in statutory duties and tax officer should face the liability in respect of negligence, default, breach of duty or breach of trust, of which the officer may be guilty. By the rule of law, people should have come to believe that corruption is no longer a problem as it was in the past. This means that the struggle has been successful. Nevertheless, the DGT has to have the right law in place including sanctions. It is a legal framework that gives certainty to taxpayers including the efficient mechanisms for monitoring and controlling officers and for reporting and punishing acts of corruption.

The challenge is towards the restoration of the rule of law. This should begin with clear and sound tax law. The DGT should constantly re-evaluate the quality and efficiency of the tax services with participation from stakeholders. However, the DGT alone is not enough. The DGT needs to work together with other stakeholders to ensure that the rule of law is maintained.

### ***3.3.5 Effectiveness and Efficiency***

Effectiveness and efficiency in the DGT will not be achieved without changing the culture and behavioral patterns of tax officer and, equally, taxpayers' expectations of what a tax officer should deliver. An efficient, effective and ethical DGT will ensure public confidence in the quality of its service, in resisting corruption, and is accountable and transparent in its functions.

For example, the IT/e-government initiative may increase the effectiveness and efficiency of the DGT in its day-to-day operations and it may enhance integrity by increasing automation and transparency, improving recordkeeping, and reducing interface with taxpayers. However, the e-government is not an end in itself but a potent force that brings a valuable prospective in achieving good governance in the DGT. It requires a dedicated policy strategy and a willingness to adapt to new technologies and leadership to overcome obstacles of many sorts- education, technical, infrastructure.

### **3.3.6 Equity**

If the tax officers are corrupt, it will be impossible for taxpayer to enjoy equal treatment. The DGT staffs are expected to act impartially and to consider equity. If they receive kickbacks, they will not be able to act impartially and fairly in their work and the public will lose confidence in them.

To maintain equity, some functions perform by the DGT in enforcing the law are audit, investigation, and collection to deter noncompliance taxpayers and to keep the complying taxpayers in the roster. In addition, penalty and sanction mechanism also play important role. However, this law enforcement function and penalty mechanism has the potential to be used in abusive manner. For example, a taxpayer, who failed to file the tax return negligently, would be punished by imprisonment of a maximum of one year, while non-filers would be fined equal to 200% of their unpaid tax. Although the sanction is clear, the mechanism is seldom put into practice. Moreover, there is an opportunity for some corrupt officers to benefit from the sanction as a tool to negotiate or to extort taxpayers. In the end, the equity is far from being achieved as the compliant taxpayer keeps paying the higher price.

## **3.4 Curbing Corruption**

Is the DGT really committed taking effective and concrete action to combat all forms of corruption, bribery, and related illicit practices? The GOI has been concentrating on increasing tax revenue and the DGT has been making big progress in the modern tax offices. The DGT believes that these important tax modernization initiatives should be complemented by a corresponding public institution and private sector undertaking. President Yudhoyono, in his first Presidential speech, called for mutually supportive actions by governments and the business community to curb corruption.<sup>17</sup> More concretely, the DG asked the taxpayers to submit a correct tax return, since a false tax return would be a source of tax corruption and collusion.<sup>18</sup>

The DGT officers, as the government's money collectors, are more exposed than most other government agency officers. Corruption still exists within the DGT, and it undermines the systems and tax officers. Hence, strategies and mechanisms to promote integrity are critical for strengthening

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<sup>17</sup> "SBY to Lead Antigraft Drive". The Jakarta Post, 2004/10/21.

<sup>18</sup> "Korupsi Bermula dari SPT" (Corruption Starts from Tax Return). Kompas Newspaper, 2005/11/26.

the DGT. Experiences in many parts of the world suggest that integrity may be promoted by incentives. Specific tax administrative measures, many of which have been addressed above as mechanisms for strengthening revenue performance in their own right, also reduce the incentives and opportunities for corruption.

The DGT has amended KUP rules with explicit requirements for a high standard of ethics in performing its duty. The DGT also has proposed provisions that criminalized misconduct of tax officers who incurred losses in the government budget and who do not have commitment to eliminate the practice of tax deductions for bribes. Specifically, the DGT also urged taxpayers to promote honesty to report unreported tax dues and also transparency in all tax matters. The DGT should ensure that the highest standards of honesty and efficiency are truly practiced by tax officers, particularly in tax law enforcement.

It is also crucial for the GOI to make a strategic decision to concentrate on the so-called supply side of corruption and not only focus on the DGT. The distinction between the supply and demand sides of corruption will prove to be rather artificial in the long run, thus prompt action is essential to create strong momentum in the fight against corruption. The logic is very simple, if the tax officers sign the COC and get the higher take home pay, the influence of corruption into economies will be reduced, and the capacity of all parties to strengthen development and democracy will be substantially increased. These actions will simultaneously contribute to fair competition among business entities.

It was quite clear that the GOI was unable in the past to deal with what has become an overwhelming presence of corruption in the DGT, since it had become habit. It is not necessary to wait until there is a perfect instrument provided by the GOI to deal with the issues of corruption in the DGT, or to wait for a reform towards the positive law in Indonesia, which is conservative in requiring a high standard of proof. Therefore, the system has worked to the advantage of the corrupt tax officers. The DGT may begin the battles of corruption although the process is a daring, risky, and a long drawn-out process, particularly in catching the big fishes. However, if the DGT properly focuses on building trust not only between the tax officer and the taxpayer, but also among tax officers, then the DGT can be a world-class tax administration with integrity. In particular, if the top managers are themselves transparent, they could facilitate trust or confidence in the anti-corruption program.

The DGT faces the agenda to concentrate on how money influences tax officers. The DGT needs restructure the mechanisms and systems where all these vices exist, as the world is one interconnected community and the containment of corruption is not only the DGT's task. Therefore, the measures against corruption needs very stringent and very consistent. The GOI faces the agenda to establish new structures and intensify reforms that will destroy the base of corruption in the DGT.

If a corrupt officer is found guilty, within the context of corrupt prison system, it will not work to imprison the corruptor. The corruptor will bribe the prison officers and have a very comfortable life in prison as enjoyed by many corruptors in Indonesian prison. He may have a television set, internet connection, cellular phone, and other luxury facilities, even ability to run his business from prison. A strict punishment should be given to withdraw him from the life enjoyment and to surrender his illegally acquired resources. That is where the corruptor will feel the bitterness of prison life, not merely serving three and half months or two years in prison. This is another thing, which the GOI should seriously consider.

The attitude towards the media should be to encourage battle against corruption, to publish and disseminate information about those found guilty of corruption, and to ensure their social isolation and stigmatization. Laws are necessary, but they are not the ends to all means in the fight against corruption. The Indonesian society must have strong social sanctions including stigmatization against the corruptor. The corrupt should not be portrayed merely as criminals but also as societal rubbish so that no one dares to commit corruption anymore. Sociological theories of deterrence suggest that one of the reasons people obey the law is because of fear of social disapproval (Brooks, 2001: 25).

In line with the probability of being caught, to increase the cost of crime to the point at which these costs outweigh the benefits of corruption, penalties should be severe enough to provide incentives for people to comply with the law. Also, they should be severe enough to reassure people that there are adverse consequences for those who commit corruption.

That is the enabling environment that should be created if the GOI, the DGT in particular, is really serious in the battle against corruption. It is also vital to increase public awareness that curbing corruption in the DGT is not somebody else's job, it is not only the DGT's job, and it is not only the job of the Inspectorate General, the CEC/KPK or other oversight agencies. It is everybody's job. This is a quite challenging thing considering the widespread of corruption in the DGT. This is possible if we look at the progress



of good governance practices in the DGT. When the number of proponents grows bigger, certainly a well-governed DGT is possible.

#### **4. THE RESISTANCE TO REFORM**

The reform may help to improve public trust in the DGT. While the results of internal and external survey, impressions of taxpayers and public figures, including the elite group, were favorable, the success of this tax administration reform will not only depend on the taxpayers' satisfaction but also on the quality and motivation of staff, particularly staff assigned to the modern office. Further efforts are needed to ensure that the governance framework has a real impact on the behavior of tax officers not only in pilot project offices but also in every office.

"Getting the policy change in place is one thing but getting them implemented is another entirely," said Stephen Parker of USAID to Prof. Jeffrey Winters (Winters, 1996: 167). Parker's comments referred to the tax officers' resistance to changes against the 1980s tax administration reform. The 1980s' tax reform was mainly conceptualized by a team of foreign experts, with very minor involvement of the DGT officer. In other words, with a very minimum participatory process, it is understandable that the DGT fought the MOF at that time. Clearly, simplification of more than 48 different kinds of taxes into 3, and implementation of the self-assessment system made the opportunity to corrupt decreased substantially.

Although at present, the DGT Tax Modernization Team plays the main role in reforming the DGT, the major problem of implementing the current reform lies in the resistance of corruptible tax officers and taxpayers. This resistance apparently can be withdrawn from the general environment of public services in the Indonesian society. The tax administration of any country inevitably reflects to large extent, the nature of the country itself (Bird on Gillis's *Tax Reform in Developing Countries*, 1989: 318). Also, the current reform, similar to the previous ones, came from the top. The staffs, who dealt with the business people to bring the tax revenue in, were not consulted for the best and effective reform. This is similar to Parker had described to Winters in 1980s.

To minimize the resistance to change, two aspects of the reform process have played important roles. The first was the clear understanding of the goal of the reform among officers and consistent synchronization between concepts and implementation. Socialization and management by example are

the key factors for minimizing resistance to change by tax officers. A well-managed communication program, therefore, is critical for a successful tax reform in eradicating resistance to change. Some tax officers will need significant training and assistance particularly in computer literacy. Not only will the tax officers appreciate the value of inducting good governance practices into the DGT, but they will also understand and appreciate the consistency shown by top managers and in the end can emulate them.

As one of the modernization goals is to have high integrity and public image, the resistance is not expected to cause any reversal in the broad direction of the tax administration reform, although tax officer resistance may lead to a variation in the pace and nature of specific tax administration reforms. The motivation, confidence and pride of being a tax officer will play an important role in increasing the trustworthiness of tax officers so that the tax reform is a serious thing to consider. The high degree of continuity in key personnel performance can also contribute.

Resistance to change took form in staff resigning from the DGT service and moves out to work in private sectors. Special attention needs to be given to tax audit activities as tax auditors have a strong sense of identity and pride in belonging due to their highly specialized skill and knowledge in technical aspects of taxation, accounting and audit, and a wide margin of discretionary power they possess. In the past, tax officers indicated a preference for the audit area since this prestige derives from the greater experience and specialized technical knowledge required in this area and the discretionary power. Still, most priority was given to money, since tax audit was perceived as a lucrative job. Nevertheless, with this administration reform, the gravity of tax audit might not be as strong as before. The training and experience gained in the area of audit is very highly valued outside the DGT, hence, there is a possibility that the best staff in audit will leave for the private sector, which offers better remuneration and compensation for their skill and knowledge.

The second aspect is beyond the DGT's capacity, i.e. the direction of external reform. The DGT, at least, can cooperate under the parallel coordination or subordinated coordination by its superior. The DGT should not be left alone in trying to address the corruption within the DGT. Basically, this is a very multi-pronged effort, and every stakeholder is a partner in this effort. Every organization and every party has an important role to play and a systemic focus is critical.

It is common to have resistance to change from some people when a new system incorporating good governance is implemented. However,

greater concern is the probability of reform fatigue for tax officers. The reform will lose its impetus if the reform continues without big changes in poor governance practices. The resistance might also come from negligent taxpayers who consider the benefit they can receive from the status quo in which they can negotiate for lower taxes.

Some taxpayers may be resistant to change because of the benefits received from the status quo in terms of bribery and collusion with tax officer. The tax modernization will not mitigate this kind of problem without full support from other related public agencies. Even the best system will not able to maximize the DGT objectives of collecting government tax revenue and promote taxpayer compliance with the tax law without stakeholders' participation. Corruption does not take place only in the DGT. Indonesia has corruption everywhere. This is why it is so important that the DGT and other public and private institutions cooperate.

Due to the reluctance from some parties, afraid of being hurt politically and economically, the reforms need time, resources, and consistent long-term political support for effective and efficient tax administration. This reluctance to collect taxes efficiently and effectively without fear or favor is understandable in a country such as Indonesia, which has a fragile political foundation.

However, there have been many taxpayers and tax officers who already have ample experience in dealing with the modernization. They understand completely the need to be fully integrated with the good governance practices as shown by the surveys. Out there, they live within a rigid to change world. They have to contend with the resistance to change of outside world, particularly in other public sectors. Future studies may shed more light on the impact of resistance to change in tax administration reform.

## **5. WERE THE OBJECTIVES ACHIEVED?**

Reforming tax administration requires a better understanding of the theoretical framework outlining efficient and effective tax and administration not only based on the revenue adequacy principle. Recent governance theories stress the importance of institutions that lead to accountability and transparency in providing public services. Yet, evidence on the Indonesian tax administration reform proves a lack of initiative in the specific context of good governance, i.e. on equity, reflected in the inability to curb corrupt

activities and lack of fair law enforcement (including law enforcement to the corrupt tax officers). In other words, the reform still focused on how to increase the revenue in a short time rather than on long-term institutional concerns such as anti-corruption efforts, regardless of the positive improvement on taxpayer services and cost-effective administration in modern tax offices. Although taxpayer surveys conducted by the AC-Nielsen and the Hay Group have demonstrated a good achievement of the reform toward good governance practices, graft practices still exist as can be seen on Gayus Tambunan case, Bahasyim, and etc.

### **5.1 High Taxpayer Compliance**

As Indonesia adopts self-assessment system, the primary responsibility for the assessment process lies with the taxpayer rather than the DGT. Taxpayers are expected to understand and comply with their tax obligations. Under self-assessment system, some people may try to evade tax by not registering, not filing the return, submitting false return, and not paying taxes. Clearly, the study has shown that the DGT has failed in promoting taxpayers compliance in national level, given the low number of registered taxpayers, high number of stopfilers, substantial underreported tax due and high tax delinquency.

Seen from the fact of high noncompliance, it is clear that there is something wrong with the DGT's strategy in promoting tax compliance, regardless of the sluggish growth of economy and the large size of underground economy. The DGT can claim it has succeeded by showing the evidence of compliance in LTO and MTO, but those taxpayers already had been selected with certain criteria based on their tax potential.

The most basic factor in choosing to comply or not to comply is the tax law. Logically, the more complex the tax laws are, or the more gray areas there are, the more chance a taxpayer not to comply. The number of those who chose not to comply also grows when tax law enforcement is perceived as ineffective, implemented partially and unprofessional.

### **5.2 High Integrity**

Did the reform have positive impact on good governance practices or public image of the DGT? The answer is “yes”, but to varying degrees up to March 2010, the time when Gayus Tambunan and Bahasyim cases exploded.

The on-going reform, including gradual modernization, platform for strengthening monitoring and any noncompliance, streamlining tax procedures, e-government, and good governance practices have been improving the public trust, as shown by the favorable result of AC Nielsen's surveys. This is coupled with the strong support provided to the DGT by the GOI.

It is true that the good governance practices accompanying the reform helped the DGT minimize the chance to commit corruption in the modern tax offices. However, this simultaneously also creates moral hazard and opportunism that promotes tax corruption that lacks of monitoring sector such as tax objection handling activities. Collusion between taxpayers and tax officials continues as shown in Gayus Tambunan cases. Although the DGT reported that 406 officers have been administratively sentenced including 92 officers were heavily sentenced in 2008,<sup>19</sup> the propensity for misconduct continues to persist. There were still much unfavorable feedback about the performance of the DGT, particularly concerning the corruption practices and abuse of power.

Ironically in January 2009, President Yudhoyono just praised the DGT reform which has attributed to the decreasing of Corruption Perception Index 2009 of Indonesia. But three months later the biggest scandal of tax corruption in Indonesia history exploded: Gayus Tambunan and Bahasyim cases.

The cases seriously have destructed the public image of the DGT and staff. Indonesian people were shocked by the recent trial of Gayus Tambunan, a former IIIa-rank tax employee. It revealed how the 31-year-old Gayus conspired with tax evading companies to defraud the tax office as much of tens of millions of dollars within less than three years under the DGT modernization era.

Gayus was found in possession of Rp25 billion derived from tax manipulation. His seven safe deposit boxes contains billion rupiahs were found in different banks. The Gayus case has opened the alleged fraud involving a number of tax officials, police officers, attorneys and lawyers. Numerous suspicious transactions worth billions of rupiah through the bank accounts of some tax officials, as discovered by the PPATK, have corroborated public perception that the DGT is a rotten organization.

Gayus got a lot of money from out of DGT's business process, and that is in the appellate system. As he worked on taxpayer objections, assessed their cases, which eventually went to the Tax Court. As a tax objection officer, he had capability to utilize the information for providing

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<sup>19</sup> DGT, 2009 Annual Report.

consultation, which he was forbidden to do. And by help of Gayus, three companies under Bakrie Group are suspected of committing tax fraud in the amount of Rp2.1 trillion. Tycoon Aburizal Bakrie, the owner of the Bakrie Group which is also Golkar Party Chairman, had repeatedly denied the cases. If it is true, it would be the largest tax fraud in Indonesian history.

During the judicial process, Gayus illegally went out of detention to Bali and abroad. He paid millions of rupiah to leave his cell at the Police Mobile Brigade headquarters. He went in and out of jail at least 68 times over four months. Later, Gayus' testimony in court has disclosed the involvement of law enforcer such as police, attorney, lawyer, and judges: the *judicial mafia*. In January 2011, Gayus was sentenced by the South Jakarta District Court to seven years in prison for corruption. The case was earlier stood trial at Tangerang District Court which set him free. Yet, the bigger case with corruption, embezzlement, and money laundering are still in investigation process by the police and the CEC/KPK.

In terms of the wealth generated from corruption, the Bahasyim case was more shocking than Gayus.' Bahasyim was arrested by police, following a report from the PPATK, which noted the extraordinary amount of money flowing into his bank accounts. The former head of Jakarta Palmerah Tax Office, who got promotion at the National Development Planning Board, allegedly abused his positions at the DGT to gain profit for his own interest. The strongest evidence is the Rp. 65 billion deposited in the accounts of his family. Other evidences are the luxury houses and hectares of land he owns. However, while Gayus admitted the money had come from taxpayers, Bahasyim insisted that his assets were profits and interests from his business activities.

Bahasyim was charged with violating the 2002 Money-Laundering Law in conjunction with Law No. 25/2003 and violating the 2001 Anti-corruption Law. Bahasyim was accused of violating Article 3: 1(a), which prohibits the investment of assets that are known, or should have been known, to be the proceeds of crime in a financial services provider, whether in his or her own name or the name of some third party. Bahasyim was also accused with violating article 11 which states that a civil servant or public official who accepts a gift because of the authority vested in the civil servant by virtue of his or her office shall be liable to a minimum prison term of one year and a maximum of five years.

The cases certainly have destructed the image of the DGT in the eyes of the public. Clearly, inefficient, incompetent, and corrupt tax apparatus are a strong disincentive for potential taxpayers. Adopting good governance

elements may minimize collusion and corruption. However, the main risk in implementing this initiative is whether the DGT officers will take the governance framework seriously and adjust their behavior, or simply ignore it and continue their bad practices. The challenge is to construct a transparent and accountable system that has two primary objectives: first, to prevent fraud from taking place and, second, to inspire taxpayers' trust in a fair and decent system in which there is a realistic chance for detecting fraud, evasion, and corruption.

There are many very interesting initiatives in modernizing the DGT, in line with the setting of the COC and new monitoring framework. The DGT could have made more efforts towards accountability aspect as a very fundamental one in implementing the initiatives. What I have learned is that the DGT has now changed in doing business with the introduction of good governance practices that will result higher tax revenue to the government. Although some officers may still be involved in conducting corruption as shown in Gayus Tambunan, the current tax administration reform must go on and address the issue firmly and transparent. The cases are clear evidence that the DGT needs more serious efforts in promoting good governance to attain the status of a world-class tax administration. This is also the right way for achieving the DGT's vision and mission, and also very important way for attaining empowerment, transparency and accountability.

### **5.3 High Productivity**

Since the launching of the reform, the DGT productivity has been increasing, and even it was claimed that the first four years tax revenue (2001-2004) in total exceeded the total tax revenue during the New Order. However, the statement will mislead people without further analysis and consideration on the political and economic factors. The fact is a radical increase in tax revenue since the launching of the reform which is clear evidence that effectiveness and efficiency has increased, at least in the large, medium and 15 modernized small tax offices contributed in total almost 88% of the total national tax revenue in 2006.

The important thing to note is that the higher productivity levels, even with lower staffing resources, have been reached through continuous improvements, training, e-government, and renovation of the DGT's working environment. Among the modernization initiatives, the DGT benefits greatly from the modern tax office and e-government initiatives driven by high productivity in IT.

A major concern observed in the DGT is the potential conflict between short-term revenue collection objectives and strategic development of mid-term modernization program. For long-term perspective, the DGT initiatives must be seen in the light of the fact that tax revenue is expected to be the backbone of the development budget, and not only to cover routine budget. However, since Indonesia is desperately in need of improving revenue performance and facing severe budgetary constraints, postponing short-term gains is not an option for the GOI, the MOF and in the end the DGT. Such gains are also important to earn political support for tax administration reform. Therefore, in practice, the need to achieve the tax revenue targeted by the GOI and other indicators stated by the DGT may provoke abusive power of the DGT that in the end will destroy its image with the general public.

## **6. CONCLUDING REMARKS**

### **6.1 Concluding Comments**

Similar to any other government organization, management of the DGT is largely determined by laws, structures, procedures, technology and human resources. The DGT operates within the country's current political and administrative environment, and works within an organizational culture that is the result of decades of relative neglect for institutional development. The DGT does not operate in isolation from the rest of government and therefore the tax administration reform is certainly impossible without the support of other relevant public services. This is not an easy and simple task, and cannot be realized in short period of time.

The improvement of tax administration requires the adoption of good governance elements into every reform program. However, at macro level or national level, the strong political resistance for the improvement of tax administration would be hard to tackle without political will of the GOI. It would also be difficult without people's support.

Indonesians must realize that the taxation problem is a national problem. The management in the DGT will directly influence public life, and the trust of the public towards the GOI. Tax policy requires consistency and determination in implementation to encourage citizen, the taxpayer, but also tax officer to comply. The current tax administration reform, in other ways, will have a great impact not only on the Indonesian public administration



services but also on private sector. The impact will be much more serious than it ever has been in history, if the DGT can transform itself from one of the most corrupted institutions into a well-governed one.

Combined strong management and political commitment are the two single most important factors for strengthening tax administration. Since the organizational structure must adequately serve the current needs of the administration and function as an integral unit, the DGT has been moving from type of tax organization towards functional organization. Experience from the developed world suggests that as tax administrations gain strength, they are better served by a mode of organization based on function (Tanzi, 1995). However, restructuring is a continuous event and, as economies develop and as the DGT becomes more proficient, the structures may need to be revisited.

Actually, the very nature of a tax administration can be managed by means of simple measurement parameters such as tax revenue or tax ratio, as they are determined by the GOI and approved by the legislature. However, in the light of good governance practices, the question may be raised whether the DGT has sufficient capacities to adapt the system to the whole organization. In this regard, I would like to point out that the description of the facts of good governance practices always shown to the public by the DGT do not provide a description or assessment of the strategy documents, but rather in effort to restore public trust in the DGT. This refers to the fact that the DGT fulfills the objectives of the reform only in terms of tax revenue but not in terms of tax compliance or tax officer integrity. Therefore, conclusions on the success of the reform ought to be more nuanced to indicate the capacities the DGT generated were not sufficient to accomplish all objectives of the reform.

The achievement in terms of revenue target does not suggest that there were no problems. In spite of the on-going encouraging progress, however, the current tax ratio remains low by international standards. Although the achievement is evidence that inefficiency and corruption have been reduced, the tax administration still needs improvement since tax compliance is still low and corruption still there.

The DGT, which is well known as one of the Indonesian institutions with pervasive KKN, has been trying to curb them as part of tax administration reform, in addition to efforts towards increasing taxpayer compliance and its productivity. Among other good governance elements, the DGT has paid serious attention to participation, transparency and accountability. It needs a clear program and consistent public message to generate the neces-

sary capacities in promoting good governance. Therefore, it is necessary for the DGT to generate more capacities that can lead to the adoption of good governance practices in the whole organization as good governance practices would not only raise tax administrative effectiveness and efficiency but would also lead to restoring taxpayer confidence in the DGT.

The relationship between tax administration reform and good governance practices is multifaceted. Nevertheless, the modernization has been carrying out to reduce the opportunity of red tape practice and corruption. Leaving aside the even more complex relationship between constraints and encouragements in achieving the objectives of modernization, I simply note the existence of these constraints in the DGT in reducing corruptible officers who do not dare to do tax negotiation openly and collectively particularly in non modern tax offices. Indeed, there is reason for optimism. While fighting corruption is difficult, a dramatic internal change is taking place. It would make sense also for the DGT to involve the national anti-corruption movement and begin to take affirmative action in curbing corruption within the DGT first.

In sum, the DGT believes in reforming institutions and thereby changing incentives and implementing good governance practices. This is the real key to tackling corruption. The DGT's focus on governance, on empowerment, transparency and accountability has had increased significance in the past five years. In my opinion, the DGT is truly a very different place than it was ten years ago.

It will take time for the DGT to catch up the level of tax collection or the tax ratio accomplished by neighboring countries such as Thailand and Malaysia. In addition to the internal factors mentioned above, the level of tax collection also depends on external environment such as politics and economy. However, if the DGT can consistently implement the current reform, particularly in good governance practices, any changes, either in internal or external factors, can be treated more as opportunities than threats.

Based on the research findings, I came to a conclusion that creating tax officer compliance, honest officers through the presence of reward and punishment system, a merit based system and performance based management with support of good governance practices, can be more effective to increase taxpayer compliance than to put the burden to comply only on taxpayers. For example, giving appropriate compensation to those officers to enhance their compliance to the tax laws and regulation can also enhance taxpayer compliance. In other words, high taxpayer compliance should be enhanced by tax officer compliance. If positive rewards increase honest

responses of tax officer, this scheme can create a critical mass of people who comply. This attitude will encourage respect for the tax law which can be expanded to other laws. Thus, tax compliance can increase compliance in other areas of society as well. The DGT can be pioneer for implementation of good governance practices.

Billions of rupiah may be spent on the reform and the best systems may be introduced, but ultimately it is the people in the organization that matter. Successful tax administration requires not only balancing the services to the taxpayer and the enforcement of tax laws and regulations to promote voluntary compliance. It also involves the integrity of officers in implementing reform program, particularly those having the elements of good governance.

Nevertheless, it would be appropriate to say that currently, the DGT is a public agency already driven by the new paradigm. Tax officials are encouraged to emulate private sector ways of doing business. What might be seen as misconduct in the tax offices could be viewed as initiative in the private sector. Still, much is left to be done by the DGT in fighting corruption. Corruption is a complex and pervasive phenomenon in Indonesia and has reduced Indonesian people's confidence in the DGT and it is not that easy to gain people's trust in a short period of time.

## **6.2 Future Challenge**

In response to the future challenge, the DGT must have comprehensive communication policies that are well focused both on short and long term public relations. The DGT must also improve bottom-up feedback mechanism so that it can encourage the implementation of modernization program by creation of strong networking and the maintenance of officers' motivation.

It will be a long and hard journey for the DGT to become a big, honored, and respectful institution. It requires the spirit, integrity, consistency, hard work, and appropriate strategy. The result achieved, appreciation, and critic should encourage the spirit and creativity of tax officer to give the best performance for the DGT. The vision must be conveyed well to all officers. This is not easy because the DGT officer is not accustomed to be pro-active as most policies generated are usually instructional, top down and ad hoc.

Concerning internal support, the improvement of officer's capacity requires special attention. In order to change the paradigm, it requires sharp,

focus, and appropriate strategies. Due to limitation in human resources, the DGT needs appropriate strategy so that the existing momentum can stimulate the policy for human resource development. This is appropriate for the development of good governance in the DGT. In addition to the capacity in creating the strategic plan or action plan, its administrative policy must be supported by tax administration processes that assure the clarity of tasks, responsibility and working framework.

The DGT should keep seeking adequate methods for curbing the corruption within the DGT. In addition to the restructuring of the tax system, the GOI must develop anti-corruption measures in the DGT and implement them impartially. That is how the GOI can destroy the machinery of the corruption.

However, it takes a great deal of time for implementing good governance practices. The institutionalization of such governance elements must take root and be sustained over time before its impact can be assessed. It is not realistic to accomplish the DGT's ambitious goals to curb widespread corruption in a short period of time. The DGT is attempting to address this issue in the context of a weak political regime, a difficult economy, rising sectarian and communal violence, erosion of central authority, and greater demands from regions for political autonomy or even secession. Furthermore, if the reforms, particularly good governance practices are intended to be more than cosmetic, the involvement of civil society will need to be more developed in monitoring the operation of the DGT that is congruent with the definitions and concepts identified as 'participatory development. An emphasis on governance, in effect, demands a complete overhaul of the whole approach to public policy formulation, social organization, and requires radically new approaches to development policy.

Finally, in a positive light, the existing external constraints lie in the general characteristic of the Indonesian public service. This gives the DGT a unique advantage as a pioneer to implement good governance practices, and become an *island of integrity* in the ocean of corruption. However, as the strategic vision of the DGT cannot be independent from Indonesia's general public service capacity and actual political system, merely reforming the DGT would be insufficient. More basic reforms are needed to ensure that other related institutions in society can also realize their potentials and function accordingly. It is possible to create a clean and sound DGT if other institutions were not intertwined in a complicated chain. Therefore, the DGT reform must be accompanied by reforms of other public agencies. The reforms can be made gradually at the most appropriate time, but most

important is the commitment and political will to initiate them and the continued and determined effort to implement them consistently, so that good governance matters.

## LIST OF ABBREVIATIONS

AR	: Account Representative
CEC/KPK	: Corruption Eradication Commission ( <i>Komisi Pemberantasan Korupsi</i> )
CIDA	: Canadian International Development Agency
COC	: Code of Conduct
DG	: The Director General
DGT	: Directorate General of Taxation
DTI	: Directorate of Tax Information
E-government	: Electronic Government
FY	: Fiscal Year
GDP	: Gross Domestic Product
GOI	: The Government of Indonesia
IG	: Inspectorate General of Ministry of Finance
IT	: Information Technology
JICA	: Japan International Cooperation Agency
KKN	: <i>Korupsi, Kolusi dan Nepotisme</i> (Corruption, Collusion and Nepotism)
KUP	: Law on General Rules and Procedures for Taxation
LTO	: Large Taxpayer Office
MOF	: Ministry of Finance
MTO	: Medium Taxpayer Office
STO	: Small Taxpayer Office
TAMF	: Technical Assistance Management Facilities
TIN	: Taxpayer Identification Number
USAID	: US Agency for International Development
VAT	: Value Added Tax
www	: world wide web

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