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FINANCIAL DEVELOPMENT FOR STRONG
AND EQUITABLE GROWTH:

POLICY PAPER 5

LEVELING TAXATION PLAYING FIELD BETWEEN FINANCIAL AND NON-FINANCIAL SECTORS

February 2025



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POLICY PAPER 5

Financial Development for Strong and Equitable Growth:

LEVELING TAXATION PLAYING FIELD BETWEEN FINANCIAL AND NON-FINANCIAL SECTORS



This policy paper is part of a series derived from the “**Financial Development for Strong and Equitable Growth**” white paper, launched in February 2024. By employing the IMF’s Financial Development Index framework, which encompasses depth, access, and efficiency dimensions, each paper offers a comprehensive analysis of critical financial development issues. These papers propose targeted strategies to enhance Indonesia’s financial landscape and foster sustainable economic growth.

The policy paper series consists of:

1. Financial Product Innovation to Enhance Financing Options
2. Increasing MSME Access to Credit through Collateral Assets and Credit Information System
3. Enhancing Financial Efficiency through Banking Consolidation
4. Navigating the Road to Improve Sovereign Credit Rating
- 5. Leveling Taxation Playing Field between Financial and Non-Financial Sectors**
6. Managing Non-Performing Loan (NPL) through Asset Management Companies
7. Expanding Financial Coverage through Reform Programs
8. Leveraging the Potential of Green Financing

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Executive Summary

Indonesia's tax expenditure, particularly in the financial sector, is significant and requires a comprehensive review. In 2022, the country's tax expenditure reached 1.65% of GDP, with the financial sector accounting for 0.23%, or 14% of the total tax expenditure. This is concerning given Indonesia's low tax-to-GDP ratio of 10.9% in 2021, one of the lowest in Asia. The declining ratio, down from 13% in 2008, highlights the need to reassess tax concessions to enhance fiscal sustainability.

Tax concessions are intended to stimulate economic activity, but they contribute to Indonesia's shallow financial sector. These incentives are designed to encourage investment and economic growth, serving as alternatives to direct spending for poverty alleviation and inequality reduction. However, Indonesia's relatively low tax revenues hinder financial sector development, unlike developed countries where the financial sector contributes significantly to government income.¹ The low taxation on property transactions encourages wealth accumulation in property rather than financial assets, further limiting sectoral expansion.^{2 3}

A lack of transparency and oversight in tax concessions raises concerns about their effectiveness and fairness. Many tax concessions, whether explicit or implicit, are not subject to the same scrutiny as direct expenditures. Without proper evaluation, their efficiency and alignment with intended objectives remain questionable. Additionally, simplified tax policies, such as the final 20% tax on savings interest above IDR7.5 million, are regressive and disproportionately impact lower-income groups.

Reforming tax policies in banking and capital markets can improve progressivity and efficiency. Banking products are mostly VAT-exempt, but a tiered tax system for deposit interest could enhance fairness by applying progressive rates. Similarly, capital market tax policies could be revised to include all capital gains, whether from stocks, bonds, or property, under a marginal tax rate. Implementing tiered taxation based on asset value and investment duration could encourage long-term investments while ensuring a more equitable tax system.

A comprehensive review of tax expenditures will help level the playing field between sectors, fostering a more competitive and resilient economy. By ensuring that tax policies do not disproportionately favor certain industries, all sectors can contribute equitably to national development. This approach balances fairness by addressing regressive elements, enhances efficiency by minimizing market distortions, and considers administrative feasibility to facilitate practical implementation. Ultimately, a well-designed tax policy will recover forgone revenues effectively and align tax incentives with direct spending to maximize their value to the economy.

1 OECD, 2024

2 Economics Help, 2019

3 Demirgüç-Kunt, 2006



Image credit: Freepik

1. Background and Problem Identifications

Tax policy in many countries is designed to achieve specific economic and social objectives, such as supporting low-income families or stimulating economic activities. In some cases, tax incentives function similarly to direct fiscal expenditures, providing targeted support to specific groups. However, when used to stimulate sectors like the financial market and certain investments, tax concessions can create an uneven playing field and result in significant revenue losses. In Indonesia, the overall tax expenditure reached IDR 323.5 trillion in 2022, equivalent to 1.65% of GDP, with the financial sector accounting for IDR 44.5 trillion or 0.23% of GDP. Given Indonesia's low tax-to-GDP ratio of 10.9% in 2021, one of the lowest in Asia compared to the regional average of 19.8% and the OECD average of 34.1%⁴, a reassessment of tax concessions is critical to improving fiscal sustainability.

Indonesia's tax expenditure ratio to GDP, while lower than the global average, is substantial relative to its tax revenue and warrants closer scrutiny. At 1.65% of GDP, Indonesia's tax expenditure is lower than the global average of 3.8%. However, it represents a significant portion of the country's total tax revenues, highlighting the need for an in-depth evaluation. Moreover, current tax expenditure estimates only capture a portion of the total revenue foregone, as the methodology primarily focuses on central government revenues and explicit tax policies, overlooking implicit and regional-level incentives. This limited scope underrepresents the true fiscal impact of tax concessions and calls for a more comprehensive approach to measuring and managing tax expenditures.

Tax policies in Indonesia create disparities between the financial sector and the real sector, particularly in property taxation. Land taxes are assessed using administrative methods that do not account for the commercial activities conducted on the land. Additionally, the tax system does not differentiate between utilized and unutilized land, leading to excessive investment in property at the expense of financial assets. This tax-induced preference for property investment exacerbates asset ownership inequities, allowing wealthier individuals to accumulate large land holdings while contributing to Indonesia's persistent housing backlog.⁵ Addressing these imbalances through tax policy reforms is essential to promote a more balanced allocation of capital.

The lack of differentiation in the taxation of financial assets hinders the development of Indonesia's financial markets. Current tax policies do not distinguish between short-term and long-term financial instruments, which stems from Indonesia's unclear legal definition of money market instruments. While Law No. 4/2023 designates Bank Indonesia as the regulator of the money market⁶, and BI Regulation No. 12/2023 defines money market instruments with a maximum tenor of one year⁷, there is no clear distinction in tax policies for longer-term instruments. In contrast, certain money market funds in countries like the US are tax-exempt when invested in municipal bonds.⁸ The absence of a clear tax framework for different financial instruments limits investment opportunities and discourages market participation.

Indonesia's tax treatment of financial transactions, such as repurchase agreements (repos), imposes additional burdens and reduces their attractiveness. Repos and reverse repos, which involve the short-term use of longer-term assets for liquidity purposes, are taxed as two separate transactions in Indonesia. This tax treatment increases costs and discourages their use as an efficient liquidity management tool. A more favourable tax policy for repos could enhance market liquidity and encourage financial sector development, aligning Indonesia with global best practices.

⁴ OECD, 2024

⁵ Brilian, 2024

⁶ Law No. 4 of 2023 regarding Development and Strengthening of the Financial Sector

⁷ PBI No. 12 of 2023 concerning the Issuance of Money Market Instruments and Money Market Transactions

⁸ Investor Vanguard n.d

The regressive nature of Indonesia's tax code results in significant foregone revenues and disproportionately impacts lower-income groups. Capital gains from financial market transactions remain untaxed, while bond coupons and bank deposit interest income are subject to a flat tax rate, which fails to consider income levels or investment size. Insurance transactions, despite providing added value, are not taxed, further contributing to revenue losses. Meanwhile, the non-taxable deposit threshold of IDR7.5 million is too low, subjecting smaller deposits to the same tax rate as larger ones and placing an undue burden on low-income savers. Revising these policies could improve tax progressivity and enhance revenue collection.

Tax policies related to pension benefits act as a disincentive to long-term savings and retirement planning. The taxation of pension benefits, including the JHT program under BPJS-TK, discourages participation in pension schemes. In many countries, pension fund accumulations are tax-exempt to encourage savings and ensure financial security in retirement. Aligning Indonesia's pension tax policies with international practices could boost participation in retirement programs and reduce dependency on public welfare systems.⁹

A comprehensive review of Indonesia's tax expenditure policy, particularly in the financial sector, is urgently needed to address inefficiencies and inequities. Key questions must be addressed: What incentives are currently provided, and at what cost? Are these incentives justified and aligned with Indonesia's development needs? How do they compare with tax policies in countries at similar stages of development? Are the current incentives achieving their intended objectives? Lastly, could these incentives be reduced or redesigned without negatively impacting economic activity? Answering these questions through a thorough review will provide a clearer understanding of tax expenditures and enable more effective policy design.

⁹ OECD, 2021

2. Literature Review and Benchmarking

2.1 Financial Sector Components and Impact on Taxation

The financial sector comprises institutions, markets, and instruments that play distinct roles in the economy, including capital intermediation, risk management, and liquidity provision. It includes banks, non-bank financial institutions (e.g., insurance companies, pension funds, finance companies), capital market institutions (e.g., mutual funds, stock exchanges, bond markets, stockbrokers, investment banks), and specialized entities such as venture capital firms, guarantee institutions, and infrastructure finance companies.¹⁰ It is important to distinguish between institutions, markets and financial instruments being traded.¹¹ Financial institutions intermediate between capital suppliers and demanders, provide risk coverage, facilitate payments, and offer investment services. Markets support price discovery, liquidity, risk transfer, and capital allocation, while instruments are traded by institutions within these markets. These diverse roles often result in differences in regulation and taxation compared to the non-financial sector, making it critical to address these distinctions when creating a fair taxation framework.

2.2 Types of Taxations

Taxation on the financial sector takes several forms. First is a tax on financial transactions such as the exchange of stocks, bonds, and others. Second is a tax on financial institutions. Third is a tax on banks, both for its services and the institutions themselves. It should be noted that taxes can affect price discovery, liquidity and in some cases (especially for derivatives) taxes can affect volatility as well.¹²

Taxation of the financial sector also faces a tug of war between the need to lower transaction costs (including taxes) to engender a deep and well-functioning financial sector. At the same time the financial sector sometimes requires a government bail-out, owing to its systemic boom-bust nature. And the cost of these bailouts can be significant, amounting to 3-5% of a country's GDP. In addition, these governments often also allocate up to 17% of GDP in the form of government guarantees for financial institutions. Hence several states, especially in Europe and North America have introduced new taxes to recover the costs of supporting their financial sectors.¹³

2.3 Fairness of Taxation

Fairness of taxation is an important topic, as distortion in the taxation regime could heighten risk of a financial crisis. This is because distortion in the tax system, especially when a value added tax is not applied to the financial sector, is alleged to cause disproportionate growth of financial sector, especially that of derivatives than in the end resulted in the 2008 global financial crisis. Also, the tax loophole whereby borrowers can deduct interest cost from their taxable income resulted in disproportionate reliance on debt rather than equity financing.¹⁴ When the lending sector, especially banks, face trouble with the rise in non-performing loans, it can quickly create failure events that require government bailouts in situations where large and systemically important institutions are involved. This is especially true when the institutions are globally systemic ones, where the origin of the crisis is in one country, but the effects are felt elsewhere. However, in most cases the government of the failing financial institution's home country will be held responsible for bailing them out.

¹⁰ IMF, 2024

¹¹ Mishkin, F., Financial markets and institutions, 10th ed., 2024

¹² IMF, 2004.

¹³ Gottlieb, et.al., 2012

¹⁴ IMF, 2010

2.4 Basic Premise for Differential Tax Treatment of the Financial Sector

At a basic level, the theory proposed by Laffer suggests that reducing tax rates could raise tax revenues.¹⁵ The mechanism operates through incentives created by lower taxation that stimulate economic activity. This argument generally applies to various sectors, especially the financial industry, as economic development at certain stages requires a deep financial market.

As tax relief promotes investments, and given the unique role of the financial sector, a single Rupiah spent on tax relief for the financial industry is expected to generate more than one Rupiah in value added. Tax relief will also likely improve financial inclusion, unlock savings, and increase investments and economic growth.¹⁶

Another rationale for tax relief in the financial sector is the perception that monetary transactions carry inherent market and credit risks. Hence, tax relief can initially reduce these risks, leading to increased trading and investments. Tax policy is often employed for specific sectoral reasons, such as promoting green investment.¹⁷ From an international perspective, Indonesia competes with other countries to attract investment. Hence, favorable tax treatment can become an attractive feature for the domestic market.

Partial tax relief of the financial sector, especially in the case of value-added, is based on fairness, efficiency, and ease of application.¹⁸ Another reason is to avoid double taxation. Financial transactions involve many parties, such as banks, lenders, and debtors. Taxing them at each step would lead to double taxation. The solution is to tax only the final consumer. Determining the value added at each step is cumbersome in complex transactions such as derivatives. Hence, many jurisdictions exempt these kinds of transactions.¹⁹

There are several objections to applying tax relief to the financial sector or other sectors, collectively referred to as tax expenditures, which are often criticized for their opacity in many countries.²⁰ They are not scrutinized at the same level as the budget spending. In some cases, the approval process for tax expenditures differs from that of the overall budget. Another concern is that tax expenditures or concessions may fail to meet their objectives and are seldom reviewed. Furthermore, tax relief can be regressive because it is widening inequality.²¹

Therefore, any concessions or tax expenditures must be transparent, with their cost calculated and their impact, including distributional effects, periodically assessed. The implications for sectoral composition, growth, and other objectives of the tax expenditure should be clearly stated at the beginning of the policy consideration, and these objectives should be measured against the outcomes down the road.

2.5 Indonesia's Practice

In Indonesia, the cost of saving the financial sector is not considered when designing the tax system for the financial industry. But there is an implicit cost of regulation levied on the financial sector, as a contribution to the cost of maintaining the Financial Sector Authority (OJK). In some cases, the levies are quite large, as they are charged against assets.²² As for the bailout of depositors, Indonesia created a deposit insurance corporation which levies 0.1% of bank third party funds.²³

¹⁵ Latif et al, 2019

¹⁶ Valderrama, 2020

¹⁷ Van Parys, 2012

¹⁸ Karsino Miarso, 2021

¹⁹ Zee, Howell, 2004

²⁰ Neubig and Redonda, 2018

²¹ Borenstein and Davis, 2015

²² Bisnis.com, 2014

²³ LPS, 2024

2.6 Global Best Practices of Financial Sector Taxation

2.6.1 Corporate Income Tax

In the global arena, especially in developed countries with significantly sized financial sectors, taxes are levied at multiple layers, including at the corporate level, at the transaction level, levies for banks for macroprudential purposes, value added for services that banks provide, stamp duties for title transfers, capital gains taxes, payroll and bonus tax for highly compensated employees, tax on derivative products, and other regulations aimed at reducing tax avoidance.

In the US, UK, and Germany financial institutions pay corporate income tax, but are subject to special rules regarding interest income, expenses, and loan loss provisioning. The special rules include how much debt financial institutions can incur and how much interest income can be used for tax deductions. Furthermore, loan loss deductions which can be used to reduce taxes are limited.

2.6.2 Transaction Taxes

The aim of a transaction tax is to reduce excessive speculation in trading of securities and ensure market stability. For example, in France and Italy, share purchases in certain large companies are taxed. In the EU a proposal for transaction taxes has been adopted by several members. These taxes aim at trading of equities, bonds, and derivatives. Their rates are usually small, at 0.1-0.5%. Their aim is to discourage high frequency trades that can destabilize the market.

2.6.3 Levies and Financial Stability Charges

Many developed countries introduced bank levies or sometimes called macroprudential buffer charges following the 2008 financial crisis. It is aimed to recover government bailout costs, create a buffer for future crises and reduce excessive risk taking.

In the UK a levy is charged on the balance sheets of bank and other financial institutions based on their net liabilities (liabilities excluding equity and nationally insured deposits). In several EU countries the levies are part of the European Bank Recovery Resolution.

2.6.4 Exemptions on Value Added and Other Special Rules

In many countries the financial sector is exempted from regular value-added taxation or is subject to special rules. The main rationale for exemption is that services related to interest, lending, and insurance are difficult in nature to tax as the financial value of services are not easily separable from the product or services being provided. This can be seen in the example of loan provision.

In the EU financial services such as lending, deposits, and insurance are exempted from VAT. However, these financial institutions cannot reclaim their VAT on inputs. These include purchases of office equipment, legal fees, lease of premises, and other inputs.

2.6.5 Stamp Duty

In certain countries, the provision of financial services is subject to stamp duty, especially in transfer of share and property ownership. In the UK, for example, stamp duty for transfer of shares is taxed at 0.5%. In Hongkong, stamp duty is also levied for share transfer.

2.6.6 Capital Gains Tax

Sales of financial assets are generally subject to capital gains tax in most developed countries. However, there is a wide variety in the rates and rules on tax during sales of these instruments. Typically, long-term investments are taxed at a lower rate compared to short term ones which are considered speculative in nature. Lower taxes on long-term holdings are intended to encourage longer term investments.

In the US, assets held less than one year are taxed at marginal tax rates, while longer-term assets are given preferential rates. In the UK capital gains taxes are differentiated by level of income, distinguished into basic and higher income earners. In other countries there are deferrals for certain kinds of investment such as for pension funds and retirements accounts.

2.6.7 Payroll and Bonus Taxes

Several developed countries have introduced additional taxes on financial sector employees that get very high-performance bonuses or high compensation packages. The aim is to reduce excessive risk taking and in some cases inequality.

In France, there is a special bonus tax introduced after the 2008 financial crisis that targets banks that paid excessive bonuses to their executives and traders. Such a special tax also exists in the UK, where it too was introduced after the 2008 financial crisis.

2.6.8 Derivatives Taxes

Most developed countries have introduced taxes on derivatives, structured products, and other complex financial instruments. The aim is to prevent tax avoidance and that the timing and type of incomes from these products are properly accounted for.

In the US, the key provision for derivative taxes is the principle of mark-to-market. Other rules also exist for options and swaps. In other countries, the key provision is the imposition of a mark-to-market requirement for the recognition of unrealized gains or losses at the end of a fiscal year. In addition, complex financial products are typically accompanied with enhanced reporting requirements.

2.6.9 Anti-Tax Avoidance Measures

Most developed countries have countered aggressive tax avoidance strategies with additional rules. These include measures to limit ability of a corporation to move around profits to low tax jurisdictions. In addition, many countries now implement recommendations from the OECD on base erosion initiatives to limit tax transfer pricing and profit shifting behavior of multinational firms. The UK, Australia, and Canada have introduced general native avoidance rules that allow their tax authorities to reclassify transactions that are primarily used to avoid taxes.



Image credit: Freepik

3. Research Findings and Discussions

Levelling the taxation playing field between financial and non-financial sectors requires a reconfiguration of tax policies across various economic activities. This section examines the global and domestic tax treatment of financial services, including banking, insurance, capital markets, and pensions, as well as the taxation of deposit interest and land versus financial assets. By analyzing international best practices and Indonesia's current tax framework, this discussion identifies potential reforms to promote tax neutrality, enhance economic efficiency, and ensure a balanced approach to taxation across sectors.

3.1 The Global Record of Tax Relief in the Financial Sector

Globally, tax policies are used for various objectives, with varying costs. The global average of tax expenditures was 3.8% of global GDP in 2022.²⁴ This amount is equivalent to 23% of tax revenue collected. Developed countries typically spend more on tax expenditures than less developed ones, reflecting their more complex economic structures and policy objectives.

Table 1 compares several developed and developing countries' tax expenditures for the financial sector. It shows the total share of tax expenditure as a percentage of their GDPs along with their top 10 provisions, including those for the financial industry. Two large developing countries have smaller financial sector tax expenditure shares than developed countries. One explanation for this difference is that developed countries have more substantial financial sectors. Thus, concessions in these sectors entail higher costs than countries with smaller financial sectors. In this comparison, Indonesia ranks higher than India in overall tax expenditure, but lower than Chile regarding provision among the top 10 types of concessions given to the financial industry.

Table 1. Tax Expenditure for the Financial Sector in Selected Countries²⁵

	Year	Tax Expenditure / GDP	Tax Revenues/ GDP	Tax expenditure/ tax revenues	Revenues Foregone (USD Billion)	Top 10 Provisions as / Total
Australia	2021	7.5%	29.5%	26%	123.8	70.10%
Indonesia	2021	1.8%	11.6%	15%	20.9	67.00%
US	2021	6.1%	27.7%	22%	1.410	60.80%
UK	2021	8.3%	35.3%	23%	258.7	73.90%
Chile	2021	2.5%	23.9%	10%	7.9	71.80%
India	2021	1.2%	11.2%	11%	37	81.2%
South Korea	2021	2.6%	32.0%	8%	47.4	53.60%

²⁴ Haldelwang et.al, 2023

²⁵ GTETI, 2022

3.2 The Indonesian Record for Tax Expenditure

Indonesian tax expenditure statistics categorized tax revenues by type, including value-added tax (VAT), income tax, customs, property tax, and stamp duty. Table 2 shows that in 2022, the most significant type of tax expenditure was VAT, accounting for approximately IDR193 trillion, or around 60% of total annual tax expenditure.

Table 2. Summary of Tax Expenditure by Type of Tax (IDR trillion)²⁶

	Estimates				Projections		
	2019	2020	2021	2022	2023	2024	2025
VAT	155.2	140.9	175.3	192.8	209.4	228.1	262.3
Income tax	99.7	91.9	117.8	113.9	125.5	127.9	140.1
Customs	11.3	13.7	16.9	16.4	17.5	18	18.9
Property tax	0.1	0.05	0.04	0.03	0.03	0.03	0.02
Stamp duty				0.4	0.4	0.5	0.5
Total	266.3	246.5	310	323.5	352.8	374.5	421.7

The rise in tax expenditures for VAT in 2022 can be attributed to the increase in the VAT rate to 11% effective from that year following the issuance of Law 7/2021 on tax harmonization. The economic recovery post-pandemic also contributed to heightened economic activity, further boosting VAT collections.

Table 3 provides details of the specific sectoral distribution of tax expenditures. Manufacturing is the largest beneficiary of tax expenditures, closely followed by financial services. The primary sectors, agriculture, and mining received significant support, with tax expenditures close to IDR 48 trillion in 2022. The secondary sectors, including manufacturing and construction, were allocated IDR 79.5 trillion. However, the tertiary sectors, including financial services, transportation, education, government administration, trading, corporate services, and information, received the bulk of tax expenditures, totaling IDR129 trillion.

Table 3. Sectoral Breakdown of Tax Expenditure (IDR trillion)²⁷

Sector	Estimates				Projections		
	2019	2020	2021	2022	2023	2024	2025
Manufacturing	64.3	59.8	73.7	73.2	79.8	88.6	98.2
Financial Services	44.7	40.7	46.1	44.5	47.6	48.9	53.7
Agriculture	35.5	31.4	38.3	44.1	47.8	50.3	57.9
Transport	15.7	14.3	19.0	22.5	26.8	29.5	34.5
Education	18.8	17.0	19.7	20.8	22.8	24.3	28.5
Government Administration	16.5	22.2	25.6	20.7	24.2	23.9	26.2

²⁶ Tax Expenditure Report, 2022

²⁷ Tax Expenditure Report, 2022

Trading	13.9	11.2	15.6	15.1	15.2	15.6	17.3
Multi-sectors	9.8	9.3	11.6	13.0	14.1	14.4	15.2
Electricity and Gas	6.7	6.9	7.0	8.0	8.6	9.3	10.9
Real estate	6.9	3.4	5.6	7.1	6.3	6.3	6.8
Construction	4.3	1.9	5.0	6.3	6.3	6.5	7.1
Health	3.8	4.8	8.0	5.8	6.1	6.8	8.5
Mining	3.0	4.1	3.4	3.8	3.3	3.4	3.6
Corporate Services	2.7	1.9	2.5	3.2	3.6	3.8	4.3
Information and Communications	1.9	1.9	2.6	2.2	2.5	2.7	2.9
Accommodations and Food	1.0	0.5	1.7	1.9	2.0	2.1	2.3
Water and Sewerage	1.0	0.9	1.2	1.3	1.4	1.5	1.7
Others	15.9	14.3	23.4	30.0	34.6	36.7	42.1
Total	266.4	246.5	310	323.5	353	374.6	421.7

Regarding the recipients of tax expenditures, a significant portion goes to multi-scale businesses, including small and medium-sized enterprises (SMEs), and tax relief specific to SMEs. However, these are different programs that do not overlap. The remainder of the tax expenditures are directed toward households. The percentage of household tax benefits increased during the pandemic and is projected to continue rising gradually, as shown in Table 4.

Table 4. Recipient of Tax Expenditure (IDR trillion and percentages)²⁸

	Estimates				Projections	
	2019	2020	2021	2022	2024	2025
Various Scale Businesses	86.5	89.1	107.9	113.2	132.9	143.0
SMEs	66.0	59.1	69.6	69.7	79.5	86.2
Households	113.7	98.3	132.5	140.6	162.1	192.5
Total	266.2	246.5	310.0	323.5	374.5	421.7
% of Businesses	57.3%	60.1%	57.3%	56.5%	56.7%	54.4%
% of Households	42.7%	39.9%	42.7%	43.5%	43.3%	45.6%

In Indonesia, tax expenditure is mainly spent on supporting business activities, but a substantial welfare support program also exists. The objective of the tax expenditure is to raise welfare, followed by SME support, business climate support, and support for investment climate, as shown in Table 5. The majority of tax expenditures are directed toward welfare-raising programs. However, while spending to support investment is minimal, the overall support for business activities surpasses welfare programs. The trend indicates that welfare support is expected to grow and is projected to become the majority in 2025.

²⁸ Tax Expenditure Report, 2022

Table 5. Tax Expenditure by Objectives of the Program²⁹

	Estimates				Projections		
	2019	2020	2021	2022	2023	2024	2025
Raising Welfare	129.2	122.7	162.4	162.4	175.7	184.8	217.1
SME Support	66.0	59.1	69.6	69.7	74.8	79.5	86.2
Business Climate Support	44.9	33.4	41.4	43.6	48.6	49.8	53.6
Support for Investment Climate	26.2	31.3	36.6	47.8	53.7	60.4	64.8

3.3 Taxation on Banks

Banks generate income from three activities: income from assets, gains from realized values of assets, and fees. Asset income includes interest on marketable securities, income from placements in government bonds and central bank instruments, and income from subsidiaries. Usually, taxes on interest income are levied on an accrual basis according to an established accounting period. In some jurisdictions, income from subsidiaries is treated as corporate income; in others, it is taxed like interest income on a periodic accrual basis.

The gains and losses from realizing assets are categorized into fixed and current assets. For fixed assets, changes in realized valuation are taxed similarly to income taxation. For current assets, these are often segmented into trading or investment accounts, with the latter held to maturity. Assets in trading accounts are subjected to mark-to-market principles and taxed accordingly. On the other hand, assets held to maturity are accounted for in the bank's capital. Regarding re-purchase (repo) transactions, there remains uncertainty about the potential for double taxation due to the sell-and-buy nature of these transactions. Additionally, different countries have varying approaches to tax deductions for bad debts.

Table 6. Tax Deductions for Bad Loans in Several Countries³⁰

Country	Conditions	Tax deductible	Limitations
China	1% of loans for domestic and 3% of loans for foreign companies	Yes	None
Germany	None	Yes	The average ratio of loan losses was reduced by 40% for the past five years.
Italy	1% of qualifying loans	Yes	Maximum of 0.6% of the loan portfolio, cumulative up to 5%
Japan	Actual losses	Yes	Up to 3% of qualifying loans

²⁹ Op.cit

³⁰ Zoe, 2004

Singapore	Up to 3% of loans	Yes	Up to 3% of qualifying loans
US	Must have adequate provisions	No	N.A.

3.4 Taxation on Banks in Indonesia

In Indonesia, banks are subject to several types of taxes, including income taxes. They are also responsible for withholding taxes on individual employee incomes and interest accrued on third-party deposits. For VAT, most services provided by banks are exempt from taxes. This is typically based on the reasoning that these transactions could be simpler and more manageable to calculate. Furthermore, in Law Number 7 / 2021 on Tax Harmonization, financial services are exempted from value-added tax because they are considered strategic and essential for national economic development.³¹ Along with financial services, insurance is also exempted from value-added taxes. Banks are exempt from several kinds of value-added taxes related to their activities.

Table 7. Taxes on Banks in Indonesia³²

Type of tax	Tariff
Institutional Income tax	22%
Withholding tax for employees	5-35% progressively
Tax for imported equipment	2.5%
Withholding tax for deposits	20%

Table 8. VAT Exemptions for Banks in Indonesia³³

Type of activities	Examples
Collecting funds from the public	Providing deposit and other savings products
	Collecting fees from savings products
	Providing ATM, EDC, and other electronic services, including fund transfers
Providing loans	Interest income on corporate and individual loans, syndicated loans
	Other fees generated from loan services
Placement and borrowing from other banks	Fee and income generated from inter-bank borrowing and lending
Providing credit card and factoring services	Fee and income generated by credit card and factoring activities

³¹ Ministry of Finance Indonesia, 2021

³² Maryam, 2023

³³ Ortax, 2014

Issuance of debt instruments	Both short-term and longer-term debt (bonds) are not taxed.
Providing guarantee for third-party liabilities	Third-party issued bonds, trade-related instruments, and other debt instruments with a maximum maturity of 1 year.

However, some activities are subject to value-added taxes. These include services for non-customers and services other than core banking businesses. The main categories are services related to the capital market and safe deposit boxes.

Table 9. Banking Activities that are Levied Value-Added Taxes³⁴

Type of activities	Examples
Services for non-customers	Fund transfers
Custodial services	Custodial services
Mutual fund services	Custodial services for mutual funds, subscription, switching, and redemption fees
Safekeeping services	Safe deposit box service
Securities transaction	Buying and selling securities
Payment to third parties	Payment services such as electricity, cell phone subscriptions, and other payments
Foreign currency transactions	Transfer and receipts of foreign currency accounts
Payroll services	Payment of salaries to customers' employee accounts

3.5 How Other Countries Tax Banking Products

In other countries, value-added taxes are levied on loan interest and intermediation businesses.

For example, in Argentina, loan interest is subject to a 10.5% value-added tax, while the regular value-added tax is 21%. To become eligible for a tax credit, Argentinian lending banks must register. Additionally, financial services such as investment management, financial advisory, and other financial transactions are subject to value-added tax. Each withdrawal from deposits and withdrawals from a current account is taxed at 0.6%, while financial contracts are levied a 1% stamp duty. Contributions to the national pension fund are taxed at 18%. While Argentina's tax system is relatively simple to administer, it imposes a heavy burden on the economy, particularly on bank debtors, resulting in high borrowing costs and discouraging financial intermediation. Despite these tax policies, Argentina has faced persistent economic instability, including high inflation, currency devaluation, and repeated debt crises, which undermine the effectiveness of its financial system.

In Singapore, bank services such as loans, deposits, and investments in precious metals are exempt from value-added taxes. Digital payment tokens have also been exempted from value-added tax since 1 January 2020. Financial services that involve brokering, arranging, and underwriting capital market instruments are subject to value-added tax. The advantage of this system is its relative ease of administration. However, only some of the input tax relief can be recovered.

In Australia, banking services like deposits and loans are given value-added rebates. This rebate amounts to 75% of the input value-added tax, designed to discourage vertical integration. The advantage is that it simplifies administration and reduces the accumulation of input value-added tax.

³⁴ Ortax.org, 2014

However, the 75% threshold is arbitrary and may not accurately reflect the actual costs incurred by financial institutions.

In contrast to Indonesia, where there is no value-added tax on core banking products, the state receives additional tax revenues in Argentina, Singapore, and Australia. However, Indonesia's current approach prioritizes financial sector stability and economic development over excessive taxation that could burden businesses and consumers.

3.6 Taxation on Insurance in Indonesia

The Tax Harmonization Law 2021 introduced changes to the taxation of financial services, including insurance. Before this law, most financial services were exempt from value-added tax (VAT). However, with the enactment of the law and the issuance of Finance Minister Regulation 67/2022, commissions received by insurance agents are now subject to a 1.1% final tax, while insurance brokers are taxed at 2.2%. Despite these changes, certain aspects of the insurance industry remain exempt from VAT. The diagram below illustrates the supply chain and identifies which segments are subject to VAT.



Figure 1. Insurance Supply Chain in Indonesia and Value-Added Tax (Example of Health Insurance)

From an arbitrage opportunity point of view, an insurance company offering bundled investment products can become a tax shelter. Also, as in other financial services, some products are not taxable; some insurance products can be considered for value-added tax.

From an equity point of view, as insurance is consumed by the top 10% of individuals by income distribution, having a value-added tax on insurance products can be progressive. Certainly, segments of the population covered under government health and other insurance programs should be exempted as most subscribers are in lower income brackets.

For general insurance (non-life), if value-added tax is considered, it should be levied only on the value-added enjoyed by policyholders. In this case, the difference will be between the premium paid (plus any investment income) and claims made. In any insurance policy, there is a servicing cost:

the insurer's income from managing the pool of funds. The part that should be taxed should exclude servicing costs because it does not give any added value to the policyholder.

3.7 Taxation of Insurance in Other Countries

Countries vary in their approach to taxing insurance products, with different value-added tax (VAT) rates applied to general and life insurance.

In New Zealand, non-life insurance products are subject to a 15% value-added tax. Insurance providers pay this tax but can claim a credit on pay-outs. If insurance beneficiaries are registered as value-added taxpayers, they can deduct the input tax credit on their insurance premiums. Similar regulations apply in Australia, Singapore, and South Africa.^{35 36 37}

Other countries impose different VAT rates on general insurance. The Philippines applies a 12% VAT on premiums collected by insurance companies, while Thailand imposes a 7% rate on premiums paid. In Vietnam, non-life insurance is taxed at 10%, except for certain policies such as student insurance, health insurance covering hospital stays and surgery, and crop insurance.

Additionally, some countries also tax life insurance premiums. India imposes different tax rates depending on the product, but individuals can deduct up to INR 150,000 in premiums paid. The Philippines levies a 2% tax on gross premiums, while Malaysia applies a 6% service tax on life insurance premiums. Indonesia, however, has one of the lowest insurance tax rates in the world. As a result, the country loses potential tax revenue from this segment of financial activity.

Many countries view life insurance as having an investment component, which they believe should be taxed similarly to other financial products. Countries that do not impose a VAT on financial services, such as New Zealand, South Africa, and Australia, also do not tax life insurance. Some jurisdictions, however, tax life insurance when bundled with non-life insurance products.

3.8 Taxation on Capital Market Transactions in Indonesia

Under Law Number 7/2021 on Tax Harmonization and its implementing regulations, the value-added tax (VAT) on share sales in the stock exchange is 0.1% and treated as final. This means shareholders are not subject to capital gains tax when selling shares at a profit. Founder shareholders, who owned the company before its listing, face a higher final tax of 0.5%. Meanwhile, bond coupons are subject to a 10% final tax³⁸, and the sale of government and corporate bonds is exempt from capital gains tax. **Estimating the tax revenue foregone is complex, but one approach is to examine the value created in the Indonesian stock exchange in 2023.** Market capitalization, calculated as the total share price multiplied by outstanding shares, grew from IDR 9.5 thousand trillion at the end of 2022 to just under IDR 11.5 thousand trillion by the end of 2023, standing at a 21% increase. The total trading value in 2023 was IDR 2.4 thousand trillion, generating an estimated IDR 2.4 trillion in VAT under the current 0.1% final tax.

If, hypothetically, capital gains were taxed at the highest bracket of 35%, revenue could have been IDR 691 trillion, which is a significantly larger amount. However, this estimate is highly overstated, as it assumes all stocks were sold to realize capital gains. A more refined approach considers only the traded

³⁵ Australia Tax Office, 2015

³⁶ South Africa Revenue Service, 2023

³⁷ Inland Revenue Authority of Singapore, 2024

³⁸ Government Regulation No. 91 of 2021

value and applies the 21% market appreciation as an indicator of capital gains. Using this method, the estimated capital gain in 2023 would be IDR 504 trillion, yielding IDR 177 trillion in tax revenue at a 35% rate, this is still far exceeding the revenue from the 0.1% final tax.

3.9 Taxation on Capital Market Transactions in Other Countries

Most countries impose a capital gains tax on capital market transactions, as these are considered an increase in wealth. However, some countries exempt non-residents to attract foreign investment. In many cases, the capital gains tax rate for capital market transactions is the same as for other sectors of the economy. The table below provides examples of how different countries apply capital gains tax.

Table 10. Sample of Countries' Capital Gains Tax for Capital Market Transactions³⁹

	Corporate Capital Gains Tax (%)	Individual Capital Gains Tax (%)
Australia	Same as marginal income tax	Same as marginal income tax
Brazil	34 for residents	15% for transactions above BRL20.000
	15-22.5 for non-residents	0% for transaction below BRL20.000
China	Same as marginal income tax	20
Germany	Same as marginal income tax	25
India	10-20	Long-term investment 10
		Short-term investment 15
Indonesia	0.1-0.5	0.1-0.5
Japan	Same as marginal income tax	20.3
Korea	Same as marginal income tax	Same as marginal income tax
Malaysia	None	None
The Philippines	Same as marginal income tax	Same as marginal income tax
Thailand	Same as marginal income tax	Same as marginal income tax
UK	Same as marginal income tax	Same as marginal income tax
US	21	20
Vietnam	Same as marginal income tax	Same as marginal income tax

It is evident that most countries apply the same capital gains tax rules to capital market transactions as they do to other asset sales, such as property or businesses. However, some exceptions exist, notably Singapore and Hong Kong, which structure their capital market regulations, including taxation, to attract foreign investment and position themselves as regional or global financial hubs.

Hong Kong and Singapore's low tax rates for capital market transactions have attracted corporations to relocate their headquarters while keeping their primary business operations in their home countries. Many Chinese corporations have moved their headquarters to Hong Kong to take advantage of its favorable tax policies, conducting IPOs and subsequent share offerings there. Similarly, Singapore's low tax rates for both capital market transactions and corporate income have drawn regional companies to establish their headquarters in the country.

³⁹ PWC, 2024

3.10 Taxes on Deposit Interest in Indonesia

The banking sector in Indonesia generates the most significant income tax revenue from financial deposits, totaling nearly IDR 8.2 trillion as of January 2024. Individual depositors make up 51% of this figure, followed by corporations at 44%, with the remainder held by other entities. Deposits contribute approximately IDR3 trillion, savings account for close to IDR2.7 trillion, and checking accounts amount to nearly IDR 2.5 trillion.⁴⁰

The flat 20% tax rate on deposits in Indonesia generates significant revenue but is considered regressive, despite its administrative simplicity. Applying the guaranteed interest rate of 4.25% per annum and a flat 20% tax rate on all deposits could yield an annual tax revenue of IDR 25.9 trillion. While the uniform 20% final tax rate is easy to administer, it may be considered regressive since both small and large deposits are taxed equally. However, deposits below the threshold of IDR 7.5 million are exempt from income tax.⁴¹

A better approach would be to treat deposit interest income like other sources of income. Table 11 depicts simulation on deposit taxation configuration. In this scheme, only deposits above IDR1 billion are taxed, at 15%, then above IDR2 billion at 25% and then above IDR5 billion at 35% (see Table 11.i). Such a tax regime would result in a tax revenue drop of IDR6.5 trillion (see Table 11.ii). However, it would result in a IDR23.8 trillion transfer to deposit holders with deposit below IDR1 billion. This should be considered a boost in income of the middle-class segment in the population, and likely would result in higher consumption, resulting in higher economic growth.

Table 11. Simulation on Deposit Taxation Configuration

i. Proposed Deposit Tax Reconfiguration

Tax Rate	Min Annual Income	Max Annual Income
%	IDR billion	IDR billion
0%	-	1,000
15%	1,000	2,000
25%	2,000	5,000
35%	5,000	-

40 Indonesian Banking Statistics OJK December, 2023

41 Finance Minister Regulation No. 212 of 2018

ii. Simulation with Existing Tax Rate (Current Tax Rate: 20%)

Tiering Deposit	Midpoint of deposit	Nominal amount (IDR trillion)	Interest income per depositor	Total Interest income	Tax rate	Tax revenues
IDR Mio	IDR Mio	IDR Trillion	IDR million	IDR Trillion	%	IDR Trillion
Below 100	50	1,054	2	45	20%	9.0
100-200	150	436	6	19	20%	3.7
200-500	250	708	11	30	20%	6.0
500-1000	750	600	32	26	20%	5.1
1000-2000	1,500	525	64	22	20%	4.5
2000-5000	3,500	690	149	29	20%	5.9
Over 5000	10,000	4,691	425	199	20%	39.9
Total		8,704		370		74.0

Tiering Deposit	Midpoint of deposit	Nominal amount (IDR trillion)	Interest income per depositor	Total Interest income	Tax rate	Tax revenues
IDR Mio	IDR Mio	IDR Trillion	IDR million	IDR Trillion	%	IDR Trillion
Below 100	50	1,054	2	45	0%	0.0
100-200	150	436	6	19	0%	0.0
200-500	250	708	11	30	0%	0.0
500-1000	750	600	32	26	0%	0.0
1000-2000	1,500	525	64	22	15%	3.3
2000-5000	3,500	690	149	29	25%	7.3
Over 5000	10,000	4,691	425	199	35%	69.8
Total		8,704		370		80.5

Difference

-6.5

Bank account confidentiality complicates the linkage between individual deposits and their tax accounts in Indonesia. Accessing individual deposit information requires approval from the Minister of Finance, making it difficult to connect savings and deposits to personal tax obligations.⁴² Consequently, banks collect taxes on deposit interest without referencing the identity of depositors.

3.11 Taxes on Deposit Interest in Other Countries

Most countries apply a flat income tax rate on bank deposits, similar to Indonesia. No country imposes a transaction tax when opening a deposit account, and interest earned on deposits is generally not tax-deductible. However, some countries tax deposit interest based on marginal income tax rates, while others provide exemptions for deposits up to a certain threshold.

⁴² Law No. 7 of 1992 regarding Banking

OECD countries apply varying tax rates on bank account interest, with most using a flat rate as seen in Table 11. Among the 40 countries in the OECD research, 13 apply marginal tax rates⁴³, while three (Chile, South Africa, and the UK) offer exemptions up to a certain amount. Most countries favor a flat tax rate, though Germany, Iceland, and Lithuania also provide exemption thresholds. Only five countries (Colombia, Norway, Spain, and Switzerland) impose a net wealth tax on bank accounts, but significant exemptions ensure that only high-net-worth individuals are subject to these tax levies.

Table 12. Sample OECD Countries' Bank Account Interest Tax⁴⁴

Countries	Bank Account Interest Tax
Australia	Marginal tax rate
Canada	Marginal tax rate
Germany	A flat rate of 26%
Italy	A flat rate of 21%
Korea	Final for <20 million KRW Above that, marginal tax applies.
Spain	Tax exempted up to EUR700 thousand. Above that, marginal tax applies.
UK	Exempted up to GBP1000. Above that, marginal tax applies.
US	Marginal tax rate

3.12 Land Versus Financial Assets Taxation

Taxing unused land serves multiple purposes, including encouraging development and promoting fair land ownership. By imposing taxes, governments can discourage the accumulation of large landholdings and ensure that landowners contribute to public expenditure. Additionally, shifting taxation from labor and capital to land improves economic efficiency and reduces market distortions.

Indonesia's land tax system is based on Nilai Jual Objek Pajak (NJOP), but discrepancies between NJOP and actual market prices encourage underreporting of land sale values to minimize tax liabilities. NJOP is an administratively determined property value set by local governments. However, actual market prices are typically higher than the NJOP. The standard land tax rate is 0.2% of the NJOP after applying regional discounts. In land transactions, buyers are taxed at 5% of the land value after regional discounts, which vary by location, for instance, Jakarta currently applies a discount of IDR 250 million. Sellers, on the other hand, are subject to a 2.5% sales tax. The taxable amount is calculated based on either the purchase price or the NJOP, whichever is higher, further incentivizing the underreporting of sale prices to reduce tax obligations.

Indonesia's land sale tax structure favours asset accumulation over financial investments. The 2.5% tax rate for sellers is relatively low, with even lower rates for simple housing, and a 0% rate for transactions involving the government or state-owned enterprises with special assignments. Ideally, the land sales tax should align with capital gains tax principles, where profits from sales are subject to progressive income tax brackets. This approach would create tax equalization between labour and capital income, as well as between financial and real estate transactions.

The profit from property sales can be easily determined by calculating the difference between the initial purchase price and the final selling price, either based on the actual transaction value or, at a minimum, the NJOP (taxable land value), which reflects the land's appreciation. Rather than being a final tax, this would contribute to the seller's overall taxable income at the end of the reporting period.

⁴³ OECD, 2018

⁴⁴ OECD, 2018

Box 1: Estimate of Financial Versus Land Values

In developed countries like the US, financial assets far exceed land value. In 2022, the total land value in the US was approximately USD21.3 trillion (Statista.com), while financial assets amounted to around USD127 trillion. This results in a financial asset-to-land value ratio of about 600%.

Indonesia's land value is significantly higher than its financial assets. With a total land area of 1.9 million square kilometres (Statista.com), only 36% is usable, as 64% consists of forests. Using a hypothetical price of IDR100 thousand per square meter, the lowest recorded price in Bogor (Rumah123.com), Indonesia's total land value is estimated at IDR68.4 thousand trillion.

Indonesia's financial assets are worth far less than its land value. As of June 2024, total financial assets stood at approximately IDR28.6 thousand trillion, including IDR12 thousand trillion in stock market capitalization, IDR460 trillion in outstanding corporate bonds, IDR7.4 thousand trillion in tradable government bonds, and IDR8.7 thousand trillion in third-party bank deposits. This means financial assets are only 42% of Indonesia's land value, excluding the value of buildings.

The stark contrast between the US and Indonesia's financial asset-to-land value ratio is partly due to low land transaction volumes and minimal land ownership taxation. In Indonesia, weak taxation and infrequent land sales contribute to land being a dominant store of value, limiting the role of financial assets in wealth accumulation and economic activity.

Land remains the least-taxed asset in Indonesia, making it an attractive but economically unproductive investment. Regardless of usage, whether for commercial, residential, or idle purposes, land tax is based solely on the NJOP. This system provides long-term investment incentives while failing to encourage efficient land utilization.

Taxing unused land can promote its productive use, as demonstrated by Cambodia's recent policy.

⁴⁵ Under this regulation, unused plots larger than 5 hectares are charged a tax of 2% of their government-assessed value, while land used for commercial purposes is taxed at the regular rate. Previously, many landowners obtained tax exemptions by claiming their plots would be used for public-benefit projects such as schools; however, these promises often went unfulfilled.

3.13 Pension Fund Tax Schemes

The US 401K system, with its largely tax-exempt contributions, forms a major pool of investible funds. In 2023, this scheme held USD 7.4 trillion in assets across over 710,000 plans, benefiting around 70 million active and retired individuals. It represents the largest segment of individual retirement accounts (IRA), totalling approximately USD 13.6 trillion.⁴⁶ While non-401K contributions are also tax-exempt at the time of contribution, income tax is levied upon distribution. Together, the 401K and related IRAs are among the largest investors in both domestic and international markets, with their long-term nature allowing for extended investment horizons.

⁴⁵ Chamroeun, 2023

⁴⁶ ICI, 2021

In many OECD countries, pension income is either untaxed or receives preferential tax treatment. Numerous nations exempt pensioners from taxation, provide tax credits to offset any levies, or completely relieve pension income from tax. Recently, some countries that previously taxed pension income have either increased the minimum taxable threshold or eliminated it altogether.⁴⁷ Additionally, as the labor force ages, certain countries, such as Denmark, Iceland, the Netherlands, and Sweden, tax earned income from work at lower rates than pension income, while virtually all exempt those who are older or unable to work due to illness.

A robust, tax-advantaged pension system is vital for addressing the challenges of an aging population. In developed countries, such systems not only ensure the welfare of retirees but also help accumulate significant investible funds, serving as a form of government assistance. Although countries with younger populations, like Indonesia, may not face these pressures immediately, proactive planning is essential. Encouraging contributions from the young and productive workforce now will ease the future financial burden on government funding as the population ages.

3.14 Tax Treatment of Repurchase Agreement (Repo) Transactions

A repo transaction is a short-term financial agreement where a security owner sells an asset with the commitment to repurchase it later at a predetermined price. In such a transaction, the underlying asset can have a long tenor (for example, a 10-year instrument), yet the repo itself is typically short-term, sometimes as brief as three months.

In Indonesia, repos are treated as two separate transactions, a sale and a repurchase, each subject to the prevailing tax rules, with no special tax treatment applied. For instance, if the seller sells at a higher price than the original purchase price, the resulting capital gain is taxable, and any coupon received by the buyer between the sale and repurchase is treated as taxable income.

In most jurisdictions, repo transactions are regarded as secured lending or collateralized borrowing, with the original security owner retaining tax ownership of the asset's income. Under a master repo agreement, actual ownership remains with the seller, making them responsible for any income generated by the asset. The buyer, acting as a liquidity lender, is typically taxed later on its corporate profits rather than on each individual transaction. However, if the repo agreement permits the buyer to sell the underlying asset to a third party, the transaction becomes a genuine sell-and-buy, resulting in a transfer of tax ownership.

The US repo market plays a critical role in providing liquidity to financial and real sectors. As of July 2024, the US repo market, covering corporate, municipal, and government bonds, was valued at USD 3.5 trillion, while the reverse repo market reached USD 2.6 trillion. Approximately 70% of these transactions are overnight, with the remainder occurring weekly or monthly, and about 80% of the underlying assets are US treasuries (the rest are mortgage-backed securities).⁴⁸ A deep repo market not only lowers the cost of holding cash on balance sheets but also reduces economic fragmentation and contributes to more efficient asset pricing.

⁴⁷ OECD, 2023

⁴⁸ Kolchin, Podziemski and Mostafa, 2022



Image credit: Freepik

4. Conclusion and Recommendations

Indonesia's tax expenditures are substantial relative to its overall tax revenues. They amount to 1.65% of GDP compared to 10.9% for tax revenues, and current estimates may only capture part of the foregone revenue. For instance, the 20% final tax on bank deposit interest and the 10% final tax on bond coupons are regressive, failing to account for the income of high-net-worth individuals. Additionally, significant revenue is lost in the insurance industry, where various elements of the value chain remain untaxed.

A comprehensive review of tax concessions, especially within the financial sector, is urgently needed. This review should address value-added tax exemptions, the imposition of final taxes on bank deposit interest, stock capital gains, and bond coupon income, and the current banking secrecy law.⁴⁹ Moreover, a unified framework that encompasses all aspects of individual and corporate capital gains, including property sales, transactions involving shares and bonds, coupon income from bond holdings, and other capital gains, would enhance tax equity and improve revenue capture.

4.1 Recommendations for Financial Sector Tax Regime

One possible consideration for deposit interest tax is establishing a threshold, for example, IDR50 million, below which no tax is imposed, but above this, the tax rate equals income tax brackets. And for capital market transactions, losses from stock and bond trading could be used as a tax credit. Below are some proposed tax changes for specific banking, insurance, and capital market products.

Table 13. Details of the Proposed Taxation Regime Reconfiguration for Various Financial Products

Subject	Object	Type of tax	Products	Basis
Banks	Credit card	VAT	Issuance of credit card	Issuance fee
	Debit card	VAT	Issuance of debit card	Issuance fee
	Bonds	VAT	Issuance of debt instruments	Face value
	Savings & Deposit	Withholding	Savings & Deposit	Deposits up to IDR 10 million
				Deposits 10 million - IDR 100 million
				Deposits 100 million - IDR 1 billion
				Above IDR 1 billion
Insurance	Value chain	VAT	Claim to health providers	Fee generated
			Claim to re-insurers	Fee generated

⁴⁹ Law No. 10 of 1998

Capital market	Share transactions	Income tax	Capital gains for shares held less than one year	For accounts < IDR 1 billion
				For accounts < IDR 1 billion
			Capital gains for shares held less than one year	Regardless of amount
Money market	Repo	Corporate/Income Tax	Repo settlement transaction	Repo fee for the buyer

In the comprehensive review, certain principles should be adhered to. These are:

- Equity. Is the tax policy regressive or progressive? What is the impact on income levels? How the policy affects competition.
- Efficiency. Are there externalities caused? How does the accumulation of input value-added tax occur? Integrates operations versus outsourcing. How does it affect imports versus the use of domestic inputs?
- Effectiveness. Recovery of revenue foregone. Comparison of tax exemption versus direct subsidy.

4.2 Recommendations for Land Taxes

Distinguishing between large unused land and land held for future development is essential to encourage productive utilization. In Cambodia, for example, many large pieces of land remain idle. Property developers often maintain large tracts as land banks for future development, and modern plantations or mining companies typically set aside portions of their holdings for later use. Such cases should be exempt from additional taxation. However, if a large piece of land has no plan for use within the next five years, it should incur an extra tax over and above the normal NJOP. Since these remote areas often have a low NJOP, the tax rate should be adjusted so that, once the land is put to use, taxation reverts to the normal NJOP with any buildings or facilities subsequently included in the tax base. The objective is to disincentivize idleness without discouraging eventual utilization.

Certain types of land should be exempt from additional taxation. Land dedicated to government, social, educational, religious, or other community activities should be exempt from extra taxation, as such uses inherently serve the public interest. Nonetheless, idle land plots rarely contribute significantly to these social, academic, or spiritual endeavours.

Increasing land transactions can further reduce low land utilization. Facilitating the transfer of ownership or lease agreements to parties with immediate and concrete plans for productive use, such as for agricultural, industrial, or residential development, can stimulate economic growth in underdeveloped areas. Creating incentives for landowners to sell or lease idle land will encourage better utilization and contribute to overall economic development.



Image credit: Freepik

5. Recommendations for Regulatory Adjustments

Several regulations need to be revisited to review the taxation regime in the financial sector.

Table 14. Recommendations for Regulatory Review

No	Problem	Sector	Existing Regulations	Recommended Change in Regulation (List of Proposed Taxation is on Table 12)	Policy Adjustment Timeline
1	VAT Exemptions not yet optimal for several sectors	Exemption on VAT for financial services	Law 7/2021 on Tax Harmonization at article 16B.1a.j. and Government Regulation no. 44/2022 at article 10.d states that Financial Services are exempted from VAT	The Ministry of Finance should revise the regulation to ensure core banking services should not be exempted from VAT.	Short to Mid-Term
		Exemption on VAT for insurance services	Law 7/2021 on Tax harmonization at article 16B.1a.j and Government regulation no. 44/2022 at article 10.d states that Financial Services are exempted from VAT	The Ministry of Finance should revise the regulation to make some insurance transactions subject to VAT.	Short to Mid-Term

2	Income Tax imposition is not yet appropriate	Tax on savings and deposit interest	Minister of Finance Regulation, 212/2018 Article 5.1c states that the final tax on savings and deposit interest is 20% final at rate.	The Ministry of Finance should revise regulations to impose personal and corporate income taxes on savings and deposits, establishing a progressive system that reflects taxpayers' capacity.	Short to Mid-Term
		Tax on share trading in the stock exchange	Minister of Finance Regulation, 212/2018 at article 7.a states that deposits at IDR7.5 million are exempted from income tax	The Ministry of Finance should revise the regulation to raise the threshold for deposit income tax exemptions and align it with general income tax.	Short to Mid-Term
			Government regulation no. 14/1997 Article 1 states that Income Tax on share transactions is set at 0.1% of the gross traded amount Government regulation no. 14/1997 at 1A states that founder transactions are taxed at 0.5% of the gross traded amount	The Minister of Finance should revise regulations to impose personal and corporate income taxes on stock market trading, thereby establishing a progressive tax system.	Short to Mid-Term
3	Suboptimal Land Sales Tax Imposition	Land/ property	Government Regulation 34, 2016, article 2 states that the tax rate is 2.5% for non-simple housing and sectors, not special purpose vehicles	The Government should revise land sales regulations to treat these transactions as capital gains, implementing a progressive bracket system that taxes only the increase in value, calculated as the difference between historical cost and current price, rather than the entire sale amount.	Mid to Long-Term



Image credit: Freepress

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