Taxonomy of Economic Groups: A Proposal for Tax Supervision on High-Net-Worth Individuals (HNWI) in Indonesia

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Abstract

High Net Worth Individual (HNWI) is defined as an individual who has wealth or income on the highest scale. The role of HNWIs in a country's economy is very significant. However, in 2022 the contribution of tax revenues from all individuals (Income Tax Article 25/29 Individuals) in Indonesia will only reach 0.68% of the total national net tax revenues. In this writing, the authors aim to evaluate the effectiveness of the tax supervision policy performance of the Individual Taxpayer in Indonesia. The method used is using a descriptive qualitative approach through case studies using primary data in the form of interview results. Based on this writing, supervision of HNWIs in Indonesia is known to be not optimal. Where the supervision carried out has not been able to mitigate the risk of using Aggressive Tax Planning which, among other things, can be carried out by HNWIs using names other than the name concerned in disguising ownership of assets or income. This writing finds the most significant enabler in optimizing HNWI tax supervision is through the identification of HNWI income streams which in this writing are grouped into 8 (eight) nodes depicted in a diagram which the authors call "Taxonomy of Economic Groups". This writing finds that the risk treatment for this risk event is by changing the provisions of Article 18 paragraph (4) of the Income Tax Law.

***Keywords**: HNWI, Direct Investee, Controlled Entity, Taxonomy of Economic Groups, Risk Treatment, Risk Event.*

A. INTRODUCTION

In 2024, the Indonesian government's work program focuses on accelerating poverty reduction, improving community welfare, and long-term Human Resources (HR) development. The majority of financing for government programs in 2024, namely 71%, will come from tax revenues. This illustrates that taxes are the backbone of Indonesia's development. Based on 2024 OECD's Revenue Statistic, the contribution of Individual Taxpayer revenues of OECD member countries on the Total Tax Revenue of these countries is greater than the performance recorded by Indonesia. Where the average contribution of tax revenue from Individual Taxpayer of OECD member countries to the total tax revenue in 2022 from each country is 23.6%. On the other hand, the average contribution to income tax revenues from corporate taxpayers in these countries is 12.0%. Based on the 2022 Directorate General of Taxes (DGT) Annual Report, income from Individual Income Tax Article 25/29 was only IDR 11,675.83 trillion (0.68% of Total Net Tax Revenue). Meanwhile, tax revenues originating from corporate taxpayers amounted to IDR 385,419.89 trillion (22.45%).

The two data sources above identify differentiation in Individual Taxpayer compliance behavior. This may indicate a differentiation in the impact of policies related to the management of the tax system in Indonesia currently compared to similar policies in OECD member countries which are in fact developed countries. It can be concluded that in almost all OECD member countries, except Colombia, Individual Taxpayer is the main source of tax revenue.

Considering this condition, with the assumption that the condition of tax revenues in OECD member countries is influenced by the policies taken by the tax authorities in each country, the authors believe that an evaluation of the effectiveness of the tax supervision policy performance of the Individual Taxpayer in Indonesia is necessary.

Chan, et al., 2021 citing Foster et al., 2014; Keen et al., 2015; OECD, 2009 which found that there is a group of individuals in the top decile of income and wealth distribution who contribute the majority of the overall tax revenue from the Individual Taxpayer group. This group is generally referred to as High Net Worth Individual (HNWI).

The term HNWI is defined by the OECD (2009) as a person who has assets or income of at least USD 1 million in the form of investments or controlled assets. Where, Chen and Tsai (2018), who conducted research on the tax compliance of the rich, found that the increase in this group's assets was in line with an increase in their risk of compliance.

In 2017, according to Knight Frank reported, HNWI in Indonesia numbered 124,000, then in 2018 it increased to 129,000 and in 2019 to 134,000. It is estimated that by 2025, this number will increase by around 67%. This estimate beats India (63%), China (45%), Russia (29%), and the United States (24%).

B. LITERATURE REVIEW

1. Public Policy Concept

The process of making public policy begins with the traditional question, namely: What should be done? To answer this question, information is needed that comes from public policy recommendations. Those that will be selected are based on the most important measures, taking into account ethical norms and morality (Dunn, 2018).

2. HNWI Concept

Apart from the OECD definition, the definition from Buchanan & McLaughlin (2017) is also used with a relative approach where individuals who are called rich people in a place (both the country and the world) can be called HNWI. On the other hand, The Tax Administration Diagnostic Assessment (TADAT) also highlights the risks of HNWI involvement in aggressive tax planning and offshore tax evasion.

3. Beneficial Owner (BO) Concept

The concept of beneficial owner is regulated by the Indonesian Government through Presidential Regulation no. 13 of 2018, which is regulated as a person who owns funds or shares as a result of having three powers related to the appointment of management, control of the company and control of the benefits of a business.

C. METHOD

This writing design was prepared using a descriptive qualitative approach through case studies using primary data in the form of interview results. Meanwhile, secondary data is data from literature, the internet, public documents and related tax regulations.

D. RESULTS AND DISCUSSION

Based on the Decree of the Director General of Taxes Number KEP-389/PJ/2020, the 2020-2024 DJP Strategy Plan is regulated, one of which is efforts to increase tax compliance for High Wealth Individuals (HWI). This plan was followed up by the Director of Tax Potential and Compliance by establishing a policy related to the 2023 National Taxpayer Potential Exploration Strategy by his Memorandum which prepared as a guide for DGT employees in carrying out supervision on Taxpayer through Material Compliance Monitoring (MCM) activities.

On the other hand, the Circular Letter of the Director General of Taxes Number SE-05/2022 regulates, among other things, the procedures for preparing a supervisory priority list. This procedure regulates the implementation of the preparation of the Supervisory Priority List (SPL) at Tax Office by the Tax Office Compliance Committee at the beginning of each year. The SPL is prepared based on the National Supervision Policy and Strategy, the Supervision Strategy of the DGT Regional Office, and the Tax Office Supervision Activity Plan.

The SPL is prepared using a risk determination engine, including the Compliance Risk Management (CRM) Audit Function and Monitoring Function, with priority on taxpayers who have high risk, taking into account other variables, including HNWI and Group Companies, which are carried out simultaneously and coordinated.

Apart from using a CRM engine, since 2021 DGT has used the *Smart-Web*, an analytical data engine. This Business Intelligence engine performs network-based analysis (graph analytics) which can be used to identify BOs and business group members.

The legal reference defining the current business group known in the tax law system in Indonesia is covered by the concept of "Special Relationship" which Article 18 paragraph (4) of the Income Tax Law is deemed to exist if 3 (three) conditions are met:

1. Taxpayers have direct or indirect capital participation of at least 25% in other Taxpayers;
2. The relationship between Taxpayers and participation is at least 25% in 2 or

more Taxpayers;

3. Relationship between 2 or more Taxpayers mentioned in letter b, or
4. Taxpayer overpowers other Taxpayers, or 2 or more Taxpayers are under the same control, either directly or indirectly, or
5. There is a family relationship, either by blood or by blood, in a straight line of descent and/or to the side of one degree

Tax Amnesty

In 2016 the Indonesian Government provided tax amnesty in an effort to explore the tax potential for taxpayers including HNWI. Realized state revenue from this program reached IDR 135 trillion.

Voluntary Disclosure Program (VDP)

The Indonesian government has also implemented a Voluntary Disclosure Program (VDP) in an effort to explore the tax potential of taxpayers, including HNWIs, after the Tax Amnesty was granted.

HNWI Tax Monitoring Policy Benchmark

Authorities in Ireland (1999) obtained a list of names of bank account holders involved in a tax avoidance scheme, namely disguising assets held domestically as foreign owned. A time-limited offer is made to perpetrators to report and pay all taxes owed plus penalties and interest (capped at 100 percent of taxes owed) in exchange for immunity from prosecution and exemption from public disclosure.

Around 3,700 taxpayers made disclosures and paid EUR 227 million. Further enforcement actions were taken against 8,500 taxpayers who did not report and resulted in additional receipts of EUR 420 million, fines and interest.

A subsequent special investigation (2004) generated EUR 950 million from 15,000 Taxpayers. Voluntary Disclosure Initiatives (VDI) in 2005 (related to non-taxable funds in single premium insurance policies) and in 2009 (undeclared tax liabilities related to offshore trusts and financial structures) continue to produce significant results. By the end of 2009, VDI and related Initiatives had generated taxes of EUR 2.6 billion from 34,000 taxpayers.

In the UK, a breakthrough was made in 2017 by requiring 5 (five) large banks to submit information regarding 250,000 British residents who have 400,000 accounts abroad. HM Revenue & Customs offers a settlement where all tax must be paid plus interest and penalties. Around 64,000 taxpayers accepted the offer and paid GBP 450 million. About 10,000 of them who did not come were targeted for investigation.

In the United States, the Internal Revenue Service (IRS) offered its first VDI in 2003 to taxpayers who did not report income and accounts from abroad. Around 1,300 taxpayers paid USD 75 million, and importantly, disclosed information regarding 400 promoters of overseas tax avoidance schemes.

In 2009, the IRS launched its second VDI after investigating the promoters and suing Swiss bank UBS, resulting in receipts of USD 780 million along with a list of client names. The result was that more than 14,000 taxpayers disclosed overseas accounts in 70 countries.

Effectiveness of HNWI Tax Supervision in Indonesia

The results of interviews with 5 (five) resource persons regarding the performance of HNWI tax management that has been carried out by the DGT all stated that this had not been carried out optimally.

According to source from academic, if the effectiveness is scored 1-5, the score is still in the middle, namely a score of 3. This is because efforts to utilize data and extensification have been carried out, mapping has also been carried out but there is a point where the potential could be further increased but has not yet been achieved. According to him, HNWIs in Indonesia need to be identified as members of the group.

Based on the opinion of source from the DGT Data Analyst, the mechanism for extracting HNWI potential is not yet optimal. However, from an organizational, regulatory and IT perspective, DGT has built a mechanism for exploring the potential of HNWI.

Meanwhile, interview with resource person from the Tax Consultant circle yielded the insight that each HNWI has its own methods which are obtained from closeness to power and politics. This justifies the absence of special parameters or special police for these HNWIs. According to him, the right now, DGT policy cannot be implemented openly towards HNWI. The policies implemented are only normative through regulations as in general and do not differentiate based on social level so that they are not considered too offensive or too pretentious.

The results of interview with resource person from HNWI circle revealed that the mechanism for extracting potential was less than optimal due to regulations on HNWIs that were not yet strict.

Aggressive Tax Planning Scheme for HNWI

The need to focus on the HNWI sector was echoed by the Organization for Economic Co-operation and Development (OECD) in its publication back in 2009. The OECD believes that there are several types of HNWIs and frequent artificial loss-generating or tax-deducting schemes used to avoid taxes. The results of interviews with all the informants also identified similar risks.

Income stream

The third source added that referring to Article 18 paragraph (4) of the Income Tax Law, the DGT has its own criteria for "special relationships", one of which relates to person-to-person, namely blood or joint family relationships, which according to him needs to be "expanded in definition". According to him, HNWIs are more advanced to be able to circumvent this article, namely to be able to avoid the DGT's authority being included in it. There must be additional criteria that are not limited only legally but are substantially based on competent evidence.

The existence of entities that obscure income and/or net income has actually been indicated by the explanation of Article 32 paragraph (4) of the Law on General Provisions and Tax Procedures which, among other things, regulates "Persons who clearly have the authority to determine policies and/or make decisions in in order to carry out company activities, for example having the authority to sign contracts with third parties, sign checks, and so on, even though the person's name is not listed in the composition of the management as stated in the deed of establishment or deed of amendment, including in the definition of management...". Where the administrator has personal responsibility for taxpayer taxes as regulated in Article 32 paragraph (2) of the Law.

Source from the Tax Consultant circle is of the opinion that income stream, follow the money, spouse, descendant, fronting, SPV, creditors do indeed have a large weight. Resource person from HNWI gave the largest 100 percent weight to Income Stream because it is the easiest and the costs are not large.

Based on the weighting results, an assessment was carried out based on the weighted average method which resulted in the highest risk weighting for HNWI non-compliance being in the Income Stream at 52%. The HNWI behavior variables and tax gap do not have a significant effect on HNWI tax non-compliance. It can be concluded that the main parameter in carrying out tax supervision over HNWI lies in the completeness of data on the flow of funds from a business group which according to the sources is considered to be currently ineffective due to deficiencies in the definition in article 18 paragraph (4) of the Income Tax Law.

Therefore, the authors believe that a good standard is needed in defining an economic/business group so that more effective tax supervision can be carried out through monitoring the flow of funds that occurs. The authors tested the existence of 8 (eight) nodes which were hypothesized to be entities used by BO to obscure beneficial ownership of income and net income, in the form of (but not limited to) property/assets.

The 8 (eight) nodes consist of Ultimate Beneficial Owner (UBO), Spouse, Descendant, Nominee (Fronting), Special Purposes Vehicle/SPV (such as Trust), Trusted Entity (which the authors call "*Creditis*"), Direct Investees, and Controlled Entities. Where UBO in this case is HNWI taxpayer who are the ultimate beneficiaries of an economic group/activities. Meanwhile, Spouse here is (a) partner from UBO who is not limited by formal legal (legitimate wife or not) or even by social norms (such as the opposite sex).

Then there is a flow to Nominees (Fronting) which the authors translate as officials/advisers of companies in the Group owned by UBO, whose names are written in the Articles of Association of companies in the UBO Group with the aim of obscuring UBO's ownership of (some of) the company's shares. And because in the civil law system in Indonesia this is not accommodated, usually this vehicle is located or registered in common law countries.

Likewise, a Special Purposes Vehicle/SPV (such as a Trust) is known in countries with a common law system, which is a company established to obscure UBO ownership in a company by using the name of an employee providing Fiduciary legal services (which is not in the form of a contract) in the form of a Trust.

Then there are also fund flow relationships with other parties who do not have work or family relationships which are not accommodated in the form of formal contracts, which in this case the authors call trusted entities ("*Creditis*"). Creditis, among other things, provides loans to UBO without written documents with a certain rate of return.

Then the six nodes are related to 2 (two) nodes consisting of Direct Investee which the author defines as an investment place that includes the name of one or more nodes from the previous six nodes as capital owners in the founding documents. And Controlled Entity is an entity that does not formally include the names of the nodes but which is actually a control entity in the company concerned.

These eight nodes are depicted as follows in the picture which the authors call in this paper the "Taxonomy of Economic Groups".

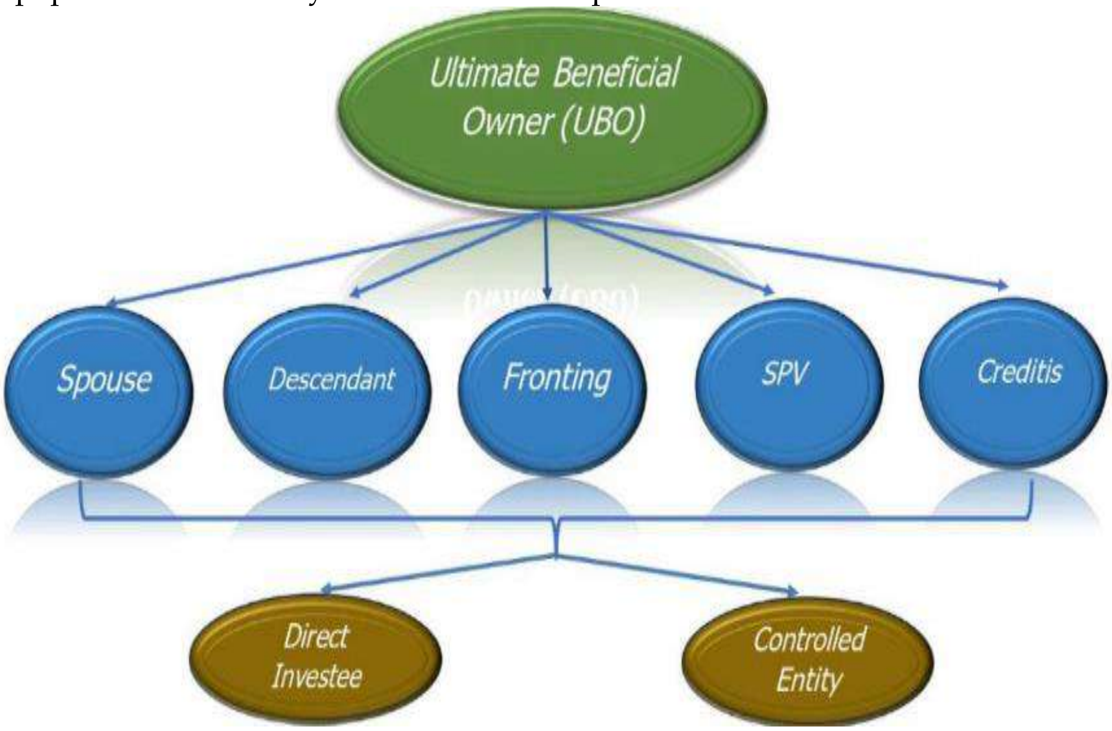

Image 1. Taxonomy of Economic Groups

E. CONCLUSION

It was concluded in this research that supervision of HNWIs in Indonesia is currently not effective and it is recommended to apply an expanded definition of "special relationships" on article 18 paragraph (4) of the Income Tax Law, by adopting the "Taxonomy of Economic Groups".

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