The Proposed Design of an Indonesian General Anti-Avoidance Rule

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Abstract: Many countries throughout the world have incorporated a General Anti-Avoidance Rule (GAAR) as part of their tax system to tackle aggressive tax planning. Consequently, a number of studies have explored aggressive tax planning practices in developed countries. However, there are fewer studies that have examined aggressive tax planning in developing countries such as Indonesia and those studies have arguably concluded that the Specific Anti-Avoidance Rules (SAARs) in Indonesia have been inadequate in dealing with inappropriate tax-related practices and suggested introducing a GAAR. This raises the issue of the appropriate design of a GAAR in Indonesia which this paper aims to explore. To answer this question, a qualitative research methodology was adopted which involved interviewing key informants from the Directorate General of Taxes (Indonesian tax authority), Tax Court judges, taxpayers and tax advisors. It is envisaged that the interviews will provide a comprehensive picture from all key stakeholders in Indonesia with regards to enacting a GAAR. Thirty two interviews have been conducted encompassing all stakeholders. Following an examination of the interview data, the paper provides preliminary evidence regarding the design of a GAAR to tackle aggressive tax planning.

Key words: Aggressive tax planning • Tax avoidance • General anti-avoidance rule (GAAR) • Specific anti-avoidance rules (SAARs)

INTRODUCTION

The aim of this paper is to explore the design of an Indonesian General Anti-Avoidance Rule (GAAR). As a developing country, Indonesia currently faces the problem of tax avoidance as evidenced by 70% of foreign direct investment companies not paying taxes as a result of reporting losses that were generated through the use of tax avoidance schemes such as transfer pricing [1]. The Indonesian Minister of Finance stated that 750 Controlled Foreign Companies (CFCs) avoided taxes by reporting losses in five consecutive years [2]. According to data from the Directorate General of Taxes (DGT/ Indonesian tax authority), from 2001 to 2006, the percentage of taxpayers registered in the Foreign Investment Tax Office who did not pay corporate income taxes was 70.64% of the total 12,738 taxpayers [3]. Their losses were generated as a result of aggressive tax planning in the form of transfer pricing. These practices resulted in tax losses amounting to £16.5 billion and US$50 billion each year respectively in the United Kingdom and the United States of America, whereas in Indonesia, the estimated tax gap is 2 trillion Rupiahs each year from foreign investment companies only [3]. Considering the estimated tax gap (the discrepancy between taxes estimated to be collected, usually based on the Gross Domestic Product and economic growth and the actual amount collected) and the impact on national revenue of which 70% comes from taxes, the gravity of the problem in Indonesia becomes apparent.

According to Rohatgi [4], aggressive tax planning or unacceptable tax avoidance is more likely to be employed in jurisdictions that have complex legislation, unfair tax laws, unreasonably high rates of tax and complex and cumbersome tax rules. However, Ordower [5] believed that, tax avoidance and aggressive tax planning also existed in civil law jurisdictions although seemingly found more in common law jurisdictions. Evidently, aggressive tax planning which leads to unacceptable tax avoidance is a general problem faced by tax authorities globally.
Literature Review

Aggressive Tax Planning and Tax Avoidance: Murphy [6] defined aggressive tax planning as “the situation where there is a reasonable probability that a particular tax return stance will not be upheld by an audit and subsequent legal challenge”. Similarly, OECD [7] defined aggressive tax planning as “planning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences. Revenue bodies’ concerns relate to the risk that tax legislation can be misused to achieve results which were not foreseen by the legislators”. Consequently, aggressive tax planning involves transactions or arrangements used to minimize or reduce tax with a lack of economic substance in a manner which goes against the purpose of the legislation.

Aggressive tax planning may be considered as similar to tax avoidance. Orow [8] points out that “aggressive tax planning would often be indistinguishable from tax avoidance”. Therefore, aggressive tax planning is no longer classified as acceptable tax planning, but as unacceptable tax avoidance. When a transaction results in a difference between the purpose and the literal interpretation of the tax law, tax avoidance can occur [9]. However, the distinction between what is regarded as acceptable tax planning and unacceptable tax avoidance depends on a country’s tax law. In some cases, Finnerty et al. [10] found that legal tax planning will be considered to be unacceptable tax avoidance because there is no generally accepted meaning of tax avoidance. Tooma [11] indicated that the distinction is largely based on the taxpayer’s motive and purpose which is ascertained from the circumstances and the nature of transactions. Therefore, it is important to clearly distinguish between regular tax planning and aggressive tax planning which may lead to unacceptable tax avoidance.

Since aggressive tax planning has become an increasing concern for many countries, in 2011, the OECD issued a report on aggressive tax planning entitled “Corporate Loss Utilisation through Aggressive Tax Planning” [12]. In this report, it is suggested that the detection of aggressive tax planning techniques may be achieved through audits and disclosure initiatives which include special reporting, mandatory disclosure rules, rulings and co-operative compliance programs. However, the OECD has also found that many countries utilize a GAAR and specific anti-avoidance rule (SAAR) to deny tax benefits to taxpayers.

The OECD [12] recommended several technical strategies in combating aggressive tax planning, such as data collection improvement, cooperative compliance programmes and enhance cooperation between countries in sharing tax related information. Therefore, exchange of information in tax matters is crucial in tackling aggressive tax planning. The OECD [12] also offers specific strategies on denying or limiting tax benefits by using means such as approaches to the interpretation of tax statutes, general anti-avoidance rules and specific anti-avoidance rules. An example of the interpretation of the relevant tax provisions is the arm’s length principle which is usually imbedded in the domestic tax laws which can deny tax losses coming from transfer pricing transactions [12]. Most pertinent for present purposes is the OECD’s conclusion that GAARs have been shown to be beneficial when the relevant tax laws are difficult to apply and when there is a lack of relevant SAARs to tackle the illicit transactions.

Anti-Avoidance Rules: Anti-tax avoidance measures may be divided into two broad categories: Specific/Targeted Anti Avoidance Rules (SAARs/TAARs) and GAARs. Finnerty et al. [10] define a GAAR as “domestic rules that allow the tax authorities to re-characterize a transaction or a series of transactions that have been entered into with the (sole or main) purpose of obtaining undue tax benefits”. Similarly, Cooper [13] defines GAAR as “a tool for combating tax avoidance, it is an anti-avoidance rule”.

Studies have revealed that while SAARs may be progressively enacted to combat avoidance schemes after they have been identified, a broader, all-embracing GAAR is required, to ensure that the revenue base does not shrink on account of the failure of the legislature to keep pace with newly emerging tax avoidance schemes [11, 14, 15, 16]. By definition, SAARs accept that there will be a certain level of avoidance schemes that the legislature finds unacceptable, before these schemes can be shut down by the specific provisions in the legislation. On the other hand, GAARs attempt to strike down avoidance that is not envisaged at the time that it is drafted.

Cooper [13] illustrates that there are generally two basic types of GAAR; one is a written formula in the law which elaborates on and defines the notion of tax avoidance (prescriptive) and the other is deliberately vague and affords a degree of discretion to judges (non-prescriptive). According to Cooper [13], the law
should define the outcomes that will result in tax avoidance, the degree of artificiality of the transaction and the purpose of the taxpayer. Examples of prescriptive GAARs include Australia, New Zealand and Canada which share similar approaches, terminology and drafting. Non-prescriptive GAARs include countries such as Brazil and China where GAARs have been drafted in less detail. The United Kingdom’s GAAR operates in between these GAAR models. After analysing judicially-created anti avoidance doctrines, Edgar [17] suggests incorporating a GAAR in the legislation which can easily identify tax avoidance transactions and reduce the judges’ interpretation role.

Cooper [14] indicates that there are four common design elements of GAAR. The first one is defining tax avoidance or the provision to invoke a GAAR, which can be based on the type of transactions, the objective of taxpayers, or other different criteria. The second one is the definition of tax benefit. This clause should explain the types of tax benefits received by taxpayers, which may result from avoidance, reduction or deferral of taxes. The third design feature is the power of reconstruction, which is the provision to allow the tax authority to reverse the tax outcome. This issue relates to the extent of discretionary power that is appropriate to confer on the tax authorities to re-characterize the transactions in question. The last feature is an issue of tax administration. This aspect is related to how the tax authorities will administer the formal procedure of the GAAR.

Furthermore, Freedman [16] states that there are five issues to be considered in designing a GAAR. The first issue is whether a GAAR is used as an approach to statutory interpretation or an overriding principle. For example, the Aaronson Report [18] makes it clear that the UK GAAR is an overriding principle which gives guidance to the judiciary. Also, there is the issue of how a GAAR relates to SAARs and that SAARs should always be used before a GAAR. The second issue is whether an objective or subjective test should be employed. Freedman thinks that the preferred approach is to use an objective test because a subjective test tends to be difficult and causes problems in its practical operation. The third issue is the burden of proof. There are different practices among different jurisdictions, but certainly this issue needs careful consideration. The fourth issue is whether a GAAR should be prescriptive in determining the counterfactual transactions or whether it should instead be less detailed and thus more flexible. The fifth issue is a GAAR’s relationship with tax treaties. In general, there should be no conflict between a GAAR and a tax treaty where adjustments under a GAAR are applied according to tax treaty provisions. However, a GAAR should not override tax treaty provisions.

**MATERIALS AND METHODS**

To address the research question and explore the appropriate the design of an Indonesian GAAR, a qualitative research method was adopted. A vast literature exists on aggressive tax planning and GAARs but arguably the literature is less developed in Indonesia. A previous empirical study on tax avoidance in Indonesia adopted a qualitative approach by interviewing three key informants [1]. This paper embarks on a similar approach in researching aggressive tax planning and makes a further contribution to the literature by interviewing all key stakeholders involved in aggressive tax planning and anti-avoidance regulations. Specifically, the research involved collecting primary data from four categories of stakeholders, i.e. tax advisors, taxpayers, tax officials and tax judges, which to the best of the researchers knowledge has not been conducted in previous studies.

A sample of 32 participants was interviewed, which consisted of 11 tax advisors, 8 tax officials, 7 taxpayers and 6 tax judges. In general, participant recruitment in this study followed a snowballing sampling technique in order to obtain an information-rich sample. Creswell [19] points out that this sampling strategy identifies cases of interest based on a chain of participants. The researcher recruited new participants by asking the interviewees whether they knew new people who might be interested in participating in recruiting tax advisors, taxpayers (represented by the tax managers of large businesses in Indonesia) and tax judges.

The research took place in Jakarta, which was chosen as it is the capital of Indonesia and is also the city where the majority of taxpayers conduct their business. Furthermore, Jakarta is where the head offices of tax firms, tax officials and tax judges, are located.

In selecting the sample, the profiles of the interviewees were initially examined to access the most experienced participants. The researcher relied heavily on the internet and social media, such as Linkedin, to recruit tax managers. After viewing the profiles of potential participants on the internet, the researcher attempted to contact them via email.
In recruiting tax advisors, the researcher retrieved their emails from their tax firms’ websites. The tax advisors interviewed represented all the big four tax accounting firms and medium tax firms present in Indonesia. Finally, in recruiting tax officials and tax judges, a formal request was made to conduct research in each institution. All interviewees recruited had a minimum of 10 year experience in the taxation field with extensive knowledge that was highly beneficial in conducting this research.

The interviews followed a semi-structured form and were conducted from mid-July to mid-October 2015. The semi-structured interview is a strategy to gain an understanding of the situation from the perspective of those who have experienced it [20]. Employing this method, the participant’s experience could be explored and it enabled the participants to elaborate on their answers. This method also enabled the researcher to expand on the questions based on the participants’ answers. A semi-structured interview of approximately 45 to 90 minutes duration was conducted where interviewees were encouraged to elaborate and expand upon their responses. All interviews were transcribed and a thematic analysis [21, 22] was employed in evaluating the interview transcripts.

RESULTS AND DISCUSSION

General Versus Prescriptive Rule: The interviews indicated that the majority of respondents preferred the more general type of GAAR with certain boundaries in the tax laws and more detailed explanation in the implementing regulations. One of the tax advisors interviewed stated,

“In my opinion, for certainty, it (the GAAR) should be stipulated in the tax law, at least what needs to be regulated. The detail is in the implementing regulations, but the implementing regulations cannot extend what is stipulated in the tax law.”

Since Indonesia is a civil law country, usually the tax law contains only the general principle and the detail is found within the implementing regulations. The tax laws usually give authority to the President or the Ministry of Finance or the Director General of Taxes to issue the implementing regulations. It is important that the implementing regulations only detail what is stipulated in the tax law.

There is a view that Indonesia already has a GAAR which is stipulated in Article 4 of the Income Tax Law (ITL) 2008 which defines “taxable income” as “any increase in economic capacity … in whatever name and form …” that contains the substance over form principle. However, the interviews showed that it is not adequate in its operation. As one of the interviewees from the tax authority stated,

“So it (the article 4 ITL) is just a regulation which is never been implemented. Substance over form is within our tax laws but it is still challenged in the Tax Court. I think we should define the GAAR, not implicitly, in certain article. There should be a special article which rules the GAAR. So, it is explicit not implicit.”

Therefore, if the GAAR should be introduced, it should be explicit to give tax authority the legal framework to execute it.

Key Elements: There are five themes that emerged from the interviews which are related to the GAAR elements. The first element is the scope of a GAAR. In identifying a scheme, a GAAR should apply to a combination of transactions where it could encompass the whole arrangement or series of transactions. Moreover, the interviews indicated that basically taxpayers and tax advisors accept whatever rulings that the government has, as long as it is stipulated in the tax laws and implemented consistently.

The second element is the purpose test which is to gauge the intent of taxpayers in conducting the transaction, which is within a GAAR and encompass a dominant/main purpose test. The taxpayer’s purpose plays an important role in deciding whether a scheme is considered aggressive or not. One of the taxpayers interviewed stated that,

“...we have to find what drives the transaction. So, there should be a business reason first, a business purpose, if it is missing or not valid, then I think it is within the area of aggressive tax planning.”

The third element is the power of reconstruction (a provision that allows the tax authority to propose an alternative tax outcome) should be included in the tax laws and further detailed in strict procedures within the
implementing regulations. This power should be handled very carefully and executed with fairness and consistency. As one taxpayer expressed his concern as follows,

“...the regulation should be clear so we can measure and anticipate from the beginning. As long as the implementation is consistent, that kind of ruling is no problem. What we are afraid of is a surprise in the future, we don’t want that. But, if the rulings are stipulated and the implementation is consistent, then why not?”

The fourth element regards the administration of the GAAR and whether a GAAR panel decides whether a case is applicable for the GAAR. The preliminary findings may indicate that there is a scheme based on the tax auditors’ work but the final decision on whether the scheme should be subjected to a GAAR rests with the GAAR panel. The tax auditors then follow up the GAAR panel’s decision. The GAAR panel should consist of experts within the DGT and/or the professionals.

The fifth element regards the burden of proof and whether it is upon the tax authority or the taxpayer to provide the evidence with transparency. There are mixed opinions on whether the tax authority or the taxpayers should provide the burden of proof. In all cases, there should be a transparency in explaining the base of the accused transaction. The party which has to supply the burden of proof can act accordingly to counter the opposing party position. As one taxpayer commented,

“...so it must be transparent, the tax authority’s view of the transaction so we can counter based on the regulations and the existing facts. There is no problem either way (whether taxpayers or tax authority provides the burden of proof), as long as, we know the reasoning for the transaction in question.”

**GAAR Interaction:** Regarding the interaction of a GAAR with the SAARs, all interviewees agree that the SAARs should be utilised first and if there is no related SAARs to the scheme in question then the GAAR should be applied. The GAAR should be the last resort and should act like a final measure in dealing with unacceptable tax avoidance.

Regarding the interaction of a GAAR with tax treaties, the evidence showed that a GAAR should complement the tax treaties but not overrule them. A GAAR as a domestic rule will be effective as long as it does not contradict the existing tax treaties. In Indonesian tax law, a tax treaty is a “lex specialis”, meaning that it can overrule domestic tax law. One tax advisor pointed out that,

“Actually (a GAAR) is a complement. In Vienna Convention (tax treaties) aim to prevent double taxation but we have to also prevent double non-taxation because of the tax treaties. There should be a balance.”

Although tax treaties are drafted to avoid double taxation, the tax authority should also make sure that double non-taxation does not occur because of that. One way to accommodate potential GAAR and tax treaties conflict is through a multilateral cooperation to enhance mutual understanding between countries with tax treaties.

**CONCLUSION**

**Findings:** It is concluded from the interviews that the design of an Indonesian GAAR requires the GAAR be incorporated into the articles of the tax laws. The GAAR should be carefully drafted and include key principles while the implementing regulations should be more detailed in explaining the GAAR application but not widen the scope of the GAAR. The regulations should be as detailed as possible to minimise discretion and to ensure consistency of application.

There are five elements that should be included in the key principles as follows:

- The scope of a GAAR: in identifying a scheme, a GAAR should apply to a combination of transactions where it could encompass the whole arrangement or series of transactions.
- The purpose test (the intent of taxpayers in conducting the transaction) included in a GAAR should be a dominant/main purpose test.
- The power of reconstruction (a provision that allows the tax authority to propose an alternative tax outcome) should be included in the tax laws and further detailed in strict procedures within the implementing regulations.
- The administration of the GAAR should include a GAAR panel who will decide whether a case is relevant for the GAAR application.
Regarding the burden of proof, the consensus is mixed as to whether the tax authority or the taxpayer should have the duty to provide the evidence with transparency.

In relation to SAARs and tax treaties, a GAAR should not be applied when the SAARs and the tax treaties apply to the scheme. If there is a SAAR related to a scheme then the SAAR should be applied instead of a GAAR. If there is a conflict between a GAAR and a tax treaty then the tax treaty should overrule the GAAR. Basically, a GAAR remains a domestic ruling and should not interfere with higher rulings such as tax treaties which encompass international agreements between sovereign countries.

**Tax Policy Implications:** There are some tax policies implications that result from the analysis which include; first, Indonesia should consider designing the GAAR according to the Indonesian context. Also, the government needs to examine whether there are other rulings affected by the implementation of the GAAR, for example the interaction between a GAAR and other government regulations related to investment.

Second, the tax authority needs to ensure that they have the necessary resources to enact a GAAR and provide adequate training for tax officials in applying the GAAR.

**Limitations:** It is acknowledged that this study is not without its limitations. For example, this research focuses only on large taxpayers which are usually handled by large and medium tax firms. Consequently, this study did not take into account small and medium taxpayers which might also be affected by the introduction of a GAAR. Second, the field work only took place in Jakarta, which is the centre of government and business in Indonesia, which excluded other areas of the country where the findings may be different.

**Further Research:** However, despite the limitations, this study is part of an ongoing research which will incorporate further legal and archival components to complement the qualitative component of the research. It is envisaged that this further research will strengthen any conclusion drawn.

**REFERENCES**


