



International Journal of Economic Research

ISSN : 0972-9380

available at <http://www.serialsjournal.com>

© Serials Publications Pvt. Ltd.

Volume 14 • Number 9 • 2017

Analysis of Tax Treatment of Personal Taxpayers Engaging in Business with Certain Gross Income (Small Enterprise)

Ning Rahayu

Faculty of Administrative Science, University of Indonesia, Jakarta, Indonesia, E-mail: ning.rahayu@yahoo.com

Abstract: Small and Medium Enterprises (SMEs) have an important role in promoting the economy. In Indonesia, Small and Medium Enterprise Sector is proven able to absorb approximately 99 million workforces and on average contribute more than 50 percent of the total GDP of Indonesia every year. Due to the important role of Small and Medium Enterprises in boosting the economy, the Government's policies concerning MSMEs, both tax policies and non-tax policies, should receive special treatment. In order to simplify taxation for small enterprises, the Government of Indonesia issued Government Regulation No. 46 of 2013 dated June 12, 2013 and Regulation of the Minister of Finance of the Republic of Indonesia No. 107 / PMK.011 / 2013 dated July 30, 2013 stipulating that on income from business received or accrued by a taxpayer having a certain gross turnover (not exceeding Rp 4,800,000,000, - in one tax year) is subject to a final Income Tax of 1% of the gross income per month. This study aims to determine the implementation of the final tax imposition, especially for individual taxpayers doing business seen from the principles of tax collection, especially the principles of equality and simplicity. This study also seeks to find out whether the imposition of final income tax which aims to provide convenience for the taxpayer can encourage taxpayers to comply with their tax obligations. This study uses qualitative approach with data collection techniques through literature study and field study by conducting in-depth interviews with informants from all relevant stakeholders and Focus Group Discussion (FGD) with private small business actors. The result of the research shows that although the main purpose of imposition of final Income Tax is to facilitate the implementation of tax obligation for small business having gross circulation not exceeding Rp 4,800,000,000, - per year, but in its implementation, especially for taxpayers, the final income tax does not meet the principles of equality because the tax treatment is different from the taxpayers of individuals who run free jobs that have the same gross turnover. The final income tax is also felt burdensome, especially for taxpayers of individuals who are just running a business and still suffer from loss or for individual taxpayers whose business turnover is still very small because the imposition of the final income tax does not recognize loss and there is no business classification based on the level of business circulation owned and non taxable income limit. As a result, numerous small entrepreneurs refuse to perform taxation obligations. In order to improve tax compliance of small entrepreneurs, the government needs to

review the related tax regulations. In line with the improvement efforts in terms of taxation regulation, another important effort is to encourage small business actors to grow and develop, among others, by providing various ease of business starting from the business licenses, funding assistance, assistance to develop the quality and competitiveness of products, promotional and marketing support and so on.

Keywords: Small and Medium Enterprise / SMEs), certain business turnover, Final Income Tax (PPh), equality principle, simplicity principle

I. INTRODUCTION

Small and Medium Enterprise (SMEs) is a very dynamic sector in the economy and is the key to economic growth (Alink & Kommer, 2011). Ngammaneeudom (2012) & Bird & Jantscher (1992) also mentions “SMEs have been accepted by the United Nations, the World Bank, the World Trade Organization, the EU, as well as among the ASEAN Economic Community (AEC) as an engine for economy Growth, enhance economic resilience, play an important role in innovation, help distribute economic wealth to remote regions of the country, reduce gender and income gaps, as well as overcome social inequality.

Small, medium and micro enterprises have a very important contribution to Indonesian economy because of the more flexible nature of SMEs in dealing with and adapting to market changes. SMEs are also able to absorb more labor and small investments.

The data of the International Finance Corporation (2010) shows that Indonesia is a country with the largest number of Micro and Small Medium Enterprises (MSMEs) in the world; it occupies the second position with the largest number of SMEs. The data of the Ministry of Cooperatives and SMEs also shows that every year the number of MSMEs in Indonesia is always increasing. The MSME sector is proven able to absorb the Indonesian workforce by an average of 99 million workforces and contribute more than 50 percent of the total GDP of Indonesia every year as shown by the table below:

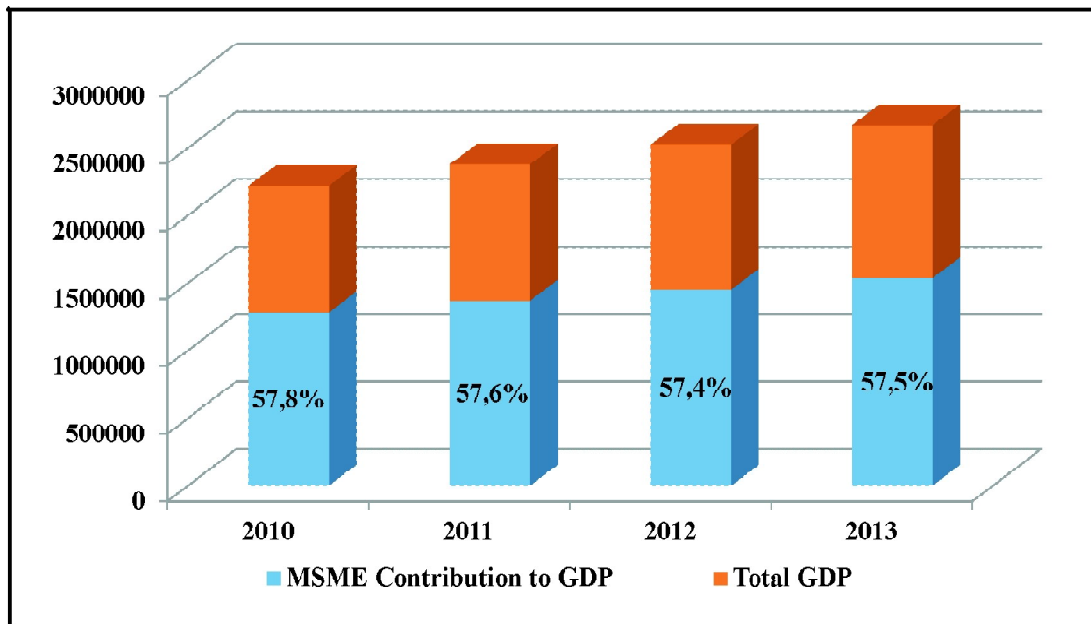


Figure I: Contribution of the MSME Sector to Indonesian GDP 2010-2013

Source: The Ministry of Cooperatives and SME of the Republic of Indonesia (processed by the Author)

The existence of these MSMEs can also open up employment opportunities, thus helping overcome unemployment problems in Indonesia. According to the head of the Central Bureau of Statistics, the number of unemployed people in Indonesia as per August 2016 reached 7.03 million people (CNN Indonesia news, November 7, 2016).

Due to the important role of MSMEs in boosting the economy, the Government's policies concerning MSMEs, both tax policies and non-tax policies, should receive special treatment. In relation to the taxation policies of these small businesses, a number of OECD countries, such as Belgium, France, Greece and Spain, apply a final tax rate to informal small business sector in order to simplify the accounting and taxation obligations (OECD Taxation and Small Business, 1994).

Similar to OECD countries, in order to simplify the taxation for MSMEs, the Government of Indonesia has issued Government Regulation No. 46 of 2013 dated June 12, 2013 and Regulation of the Minister of Finance of the Republic of Indonesia No. 107 / PMK.011 / 2013 dated July 30, 2013 which stipulate that the income from business received or obtained by a taxpayer having a certain gross income shall be subject to a final Income Tax of 1% of the Tax Basis (DPP), namely the gross monthly income. The tax subject entitled to make use of this policy is an individual or entity receiving income from business, with the gross income not exceeding Rp 4,800,000,000, - in one (1) tax year

Although the ultimate purpose of the final Income Tax is to facilitate the implementation of taxation obligations for MSMEs with certain gross income (not more than Rp 4.800.000.000, - per year), but in the implementation in the field, especially for individual taxpayers earning such gross income, the imposition of the final income tax does not meet the principles of equality because the tax treatment is different from individual taxpayer doing professional services earning the same gross income.

The imposition of final income tax is also felt burdensome, especially for individual taxpayers running new business and the business has not made profits or for individual taxpayers of individuals whose business income is still very small as the imposition of final income tax does not recognize the classification of business based on the levels of business income.

II. LITERATURE REVIEW

According to Adam Smith (quoted by Chistopher Heady, 1996), tax collection must meet the principles known as "four maxim", as follows:

- a) Equality : that people's tax payments should be in proportion to their income
- b) Centainty: that tax liabilities should be clear and certain, rather than arbitrary
- c) Convenience of payment: that taxes should be collected at a time and in a manner that is convenient for the taxpayer;and
- d) Economy in collection: that taxes should not be expensive to collect, and should not discourage business

Related to the issue of equity, Mansury (1999) mentions two kinds of equality, namely: horizontal equality and vertical equality. Horizontal equality implies that all persons who have the same economic ability should be subject to the same tax. Meanwhile Vertical Equality means that people who have different economic capabilities should be taxed differently. The greater the economic ability to pay taxes, the greater the tax rate imposed should be.

Furthermore Richard Goode (1964) states: *“Fairness is generally recognized as comprising equal treatment of equals and reasonable differences in the treatment of unequals. In regard to taxation, capacity or ability to pay is the relevant aspect of equality and inequality”*

Tax collection should also be simple to facilitate Tax Subjects to easily understand the provisions of taxation, which will facilitate them in carrying out tax obligations. On the other hand, it will facilitate tax apparatuses in conducting guidance, service, supervision on the implementation of tax obligations made by Taxpayers

Victor Thuronyi (1996) in his book *Tax Law Design* advises to apply the method of presumptive taxation on taxpayer income taxation with small business income. The application of presumptive method or estimate provides simplicity and simplification in tax calculation. The reasons for using presumptive include: a). Ease, especially for taxpayers with very low turnover and b). To cope with tax evasion

Mansury (2002) states that the grounds for the implementation of good tax administration include:

1. Clarity and simplicity of the provisions of the law that facilitate the administration which give clarity for taxpayers
2. Simplicity in juridical formation that gives ease to be understood and simplicity in the implementation by the apparatus that must be obeyed by taxpayers in fulfilling its tax obligations which will eventually reduce tax smuggling.

As the consequence, the government, especially the Directorate General of Taxes, is obliged to conduct a comprehensive and continuous publication of taxation procedures and policies in order for taxpayers to have high confidence in the implementation of their tax obligations and rights.

Another important point is that tax collection should have a positive impact on the national economy by imposing tax rates that give the opportunity to businesses to grow so the amount of profit after tax is still sufficient for investment.

III. RESEARCH METHOD

This research is conducted by using qualitative approach because this research will give a comprehensive description of the phenomenon raised.. The data collection technique in this study is literature studies and field studies through in-depth interviews with key informants, namely people who are competent in understanding the issues raised in this study. The informants are among others: officials of the Directorate General of Taxation related to the theme, tax consultants, practitioners, taxpayers and academician. Information from taxpayers, especially small entrepreneurs is also obtained through ‘Focus Group Discussions’ between the Ministry of Cooperatives and Small and Medium Enterprises with small entrepreneurs.

IV. RESULT AND DISCUSSION

Under the Indonesian taxation regulations, different tax treatments are imposed on individuals performing business and performing free work with a gross turnover of less than Rp 4.8 billion per year.

(A) Taxation Treatment on Individuals Carrying Out Business

Government Regulation of the Republic of Indonesia number 46 of 2013 dated June 12, 2013 juncto Regulation of the Minister of Finance of the Republic of Indonesia number 107 / PMK.011 / 2013 dated 30 July 2013 stipulates that the income from business received or obtained by taxpayers having certain gross income is subject to a final income tax of 1% of the Tax Imposition Base (DPP), namely the gross monthly revenue

Taxpayers who have such gross income are taxpayers who meet the following criteria:

1. Individual Taxpayers receiving income from business, with the gross income not exceeding Rp 4,800,000,000, - in one (1) tax year.
2. Excluding individuals engaging in trading activities and / or services that in the business: a). use facilities or infrastructure that can be dismantled, both permanently and non permanently b). Use part or all of the premises for public interest not intended for business or selling.

In the case of taxpayer's gross income has exceeded Rp 4,800,000,000 in a tax year, the income received or obtained by the taxpayer in the next tax year is subject to Income Tax based on the general rate of the Income Tax Law, namely progressive rate. The progressive rate according to Indonesian Income Tax Act are as follows:

- 5% x Rp 50 million
- 15% x Rp 200 million
- 25% x Rp 250 million
- 30% x remaining

(B) Taxation Treatments on Individuals Performing Professional Services

Government Regulation of the Republic of Indonesia number 46 of 2013 dated June 12, 2013 juncto Regulation of the Minister of Finance of the Republic of Indonesia number 107 / PMK.011 / 2013 dated 30 July 2013 also regulates the definition of individuals performing Professional Services that include:

- Experts performing Professional Services consisting of lawyers, accountants, architects, doctors, consultants, notaries, appraisers and actuaries.
- Music players, hosts, singers, comedians, movie stars, soap opera stars, advertising stars, directors, film crews, photo models, showmen, drama players and dancers.
- Athletes
- Counselors, teachers, trainers, preachers, extensionists and moderators
- Authors, researchers and translators
- Advertising agencies
- Project supervisors or project managers
- Intermediaries
- Merchandise salespersons
- Insurance agents

- Distributors of multilevel marketing or direct selling and other similar activities

In respect of the income received or obtained, an individual who carries out professional services mentioned above having the gross incomes of not more than Rp 4.800.000.000, - may choose to maintain books or records. If an individual Taxpayer chooses to keep books, the Income Tax to be paid is calculated in a normal way, namely from the net basis (gross income - operating costs). Conversely, if an individual taxpayer chooses to hold a record, then the Income Tax to be paid is calculated by applying the Net Income Statement as follows:

Gross income = Y

Net income = % norm x gross income (% norm x Y)

Taxable Income (PKP) = Net Income - Non-Taxable Income (PTKP)

Income tax owed = tax rate (progressive rate) x PKP

The application of Net Income Assessment Norm does not recognize loss, since the Income Tax is calculated on the basis of Gross Income without recognizing costs.

In relation to the obligation to maintain bookkeeping and recording, Article 28 of the General Provisions and Taxation Procedures Law (KUP) regulates as follows:

- The bookkeeping or record should be maintained with due regard for good faith and shall reflect the actual circumstances or business activities.
- The bookkeeping or record should be held in Indonesia using Latin letters, Arabic numerals, Rupiah currency units and prepared in Bahasa Indonesia or in foreign languages authorized by the Minister of Finance.
- The bookkeeping is organized with the principle of obedience principle and with accrual stelsel or cash stelsel
- Changes to the bookkeeping methods and / or financial year must be approved by the Director General of Taxes
- The bookkeeping shall consist of, at a minimum, records of assets, liabilities, capital, income and expenses and sales and purchases, so that the amount of the indebted tax may be calculated
- The bookkeeping using foreign languages and currencies other than Rupiah may be held by the taxpayer after obtaining permission from the Minister of Finance.
- The record consists of data collected regularly on the gross revenue and / or gross income as the basis for calculating the amount of tax payable, including non-taxable income and / or final taxable income.

The tax treatment of an individual Taxpayer who receives or obtains gross income does not exceed Rp 4.800.000.000, - per year does not meet the principles of equality, whether horizontal equality or vertical equality.

Horizontal equality requires that taxpayers with the same economic capability should be taxed as large as equal to their business or activity status. Meanwhile, vertical equality requires that taxpayers of different capacities should be taxed differently with regard t the rate (Mansury, 1999). Referring to the applicable provisions, an individual taxpayer with a gross income of Rp 4.800.000.000, - per annum received or

accrued from business and from a professional services shall be subject to an income tax with different rate, even though they have the same economic ability. For example, please see the illustration below:

Mr. A and Mr. B are unmarried (single) earning a gross annual income of Rp 2,000,000,000 per year. Mr. A runs a business, while Mr. B does a professional services. The costs incurred by Mr. A and Mr. B are equally Rp 1,200,000,000, -. The tax treatments on both are as follows:

(a) Tax Treatment for Mr. A

Mr. A will be subject to an income tax of 1% of the gross amount of his income, namely: $1\% \times \text{Rp } 2,000,000,000, - = \text{Rp } 20,000,000, -$ which shall be final

(b) Tax Treatment for Mr. B

In this case the Income Tax owed by Mr. B will differ greatly if Mr. B elects to keep books and if he chooses to organize records.

b.1. If Mr. A Chooses to Keep Books

- Net Income = Rp 2,000,000,000, - - Rp 1,200,000,000, - = Rp 800,000,000, -
- Taxable Income = Net Income - Non-Taxable Income for Single Status, namely: Rp 800,000,000, - - Rp 54,000,000, - = Rp 746,000,000,-
- Income Tax Payable = Taxable Income x progressive tariff, namely
 - 5% x Rp 50.000.000, - = Rp 2,500,000, -
 - 15% x Rp 200,000,000, - = Rp 30.000.000, -
 - 25% xRp250.000.000, - = Rp 62.500.000, -
 - 30% x Rp 246,000,000, - = Rp 73,800,000, -
 - Total Tax = Rp168,800,000, -

b.2. If Mr. A Chooses to Hold Records

Because Mr. A chooses to keep records, the Income Tax will be calculated by applying the Net Income Norm. If the percentage of norms for Mr. A's business is 30%, then the income tax calculation payable is as follows:

- Net income = % norm x gross income, namely $45\% \times \text{Rp } 2,000,000,000, - = \text{Rp } 900,000,000, -$
- Taxable Income = Net Income - Non-Taxable Income (PTKP) for single status, Rp 900,000,000, - - Rp 54,000,000 = Rp 846.000.000, -
- Income Tax Payable = Taxable Income x progressive rate, namely
 - 5% x Rp 50,000,000, - = Rp 2,500,000, -
 - 15%x Rp 200,000,000, - = Rp 30,000,000, -
 - 25% xRp250,000,000, - = Rp 62,500,000, -
 - 30% x Rp 346,000,000, - =Rp103,800,000, -
 - Total Tax = Rp198,800,000, -

From the above case examples it is clear that Mr. A and Mr. B that have the same economic ability are subject to different Income Taxes.

If Mr. A and Mr. B incur losses, Mr. A who carries on business will still be required to pay a Final Income Tax of $1\% \times \text{Rp } 2,000,000, - = \text{Rp } 20,000,000, -$. Meanwhile Mr. B who runs free work will be exposed to different taxes. If Mr. B chooses to keep books, Mr. B will not be subject to Income Tax, while if Mr. B chooses to hold records, Mr. B will be subject to Income Tax on a gross basis and there is no recognition of costs.

In addition to not meeting the principle of equality, the tax treatments above do not meet the convenience principle in which taxes should be imposed on a taxpayer when he is in a convenience state. In this case even though the taxpayer in a state of loss, but the taxpayers still have to pay taxes. This can be seen in the case of Mr. A and Mr. B if they choose to hold records. Meanwhile, in Mr. B's case if he chooses to keep books, he does not pay the Income Tax.

In the practice, especially for individual taxpayers who run businesses, this kind of treatment of imposition of final income tax is very burdensome, especially in the early business where their business income is still low or still experience loss. This taxpayer has no option as individual taxpayers who perform free work. Such circumstances make them difficult to grow and may potentially cause tax arrears. Actually, the Indonesian General Provisions and Procedure of Taxes (KUP) allow taxpayers to apply for installment in the payments of taxes payable, but the installment payments will be subject to 2% monthly interest from the amount of unpaid taxes making it does not provide a solution to the difficulties of the taxpayer concerned. Faced with this fact, finally many of them choose not to carry out their taxation obligations in the form of depositing or reporting taxes. Based on data from the Directorate General of Taxes in 2016, it is known there are 1,231,835 registered small and medium enterprises taxpayers, consisting of 991,645 individual taxpayers and 240,190 corporate taxpayers. Out of such figure, in 2015, only 430,876 taxpayers reported their tax return (SPT) while 774,216 taxpayers do not report.

In fact, it is often because of the tax debt, in the end their business fails. This is not in line with the principle that taxation policies should not distort the business.

Judging from the principle of simplicity, the application of presumptive taxation method, namely the application of a final income tax of 1% of gross income is indeed looks simple and easy, however the absence of limit of non taxable income for small entrepreneurs has made the application of the method burdensome for individual taxpayers running business with low gross income.

Considering the above facts, the government should review the application of final Income Tax for taxpayers with certain gross income (not more than Rp 4.800.000.000, - per year), especially taxpayers of individuals who run businesses. The grouping of small entrepreneurs from several levels based on the income of their business is very important, as the bottom layer shall be the group that is not subject to income tax. On the next layer until the upper limit of the gross income tax, the taxpayer should be allowed the freedom to choose to keep books and calculate taxes from the net basis or to record and calculate the tax from the gross basis as applied to the taxpayer performing professional services. Therefore, there is no discrimination of taxes due to different types of activities.

To facilitate the taxpayer in the bookkeeping (for taxpayers who choose to organize personal bookkeeping), it is necessary to make rules about the implementation of simple bookkeeping to facilitate taxpayers. Easiness in the implementation of tax obligations will be very important thing in order to improve taxpayers' compliance.

In line with the improvement efforts in terms of taxation regulation, another important effort is to encourage small enterprises to grow and develop, among others, by providing various eases of business starting from business licenses, funding assistance, assistance to develop the quality and competitiveness of the products, promotion and marketing support and so on. This is in line with the strategy of developing small and medium enterprises according to World Bank, namely: a) Creating business field, b). Determining public expenditure policy by effectively utilizing public resources and c). Encouraging private involvement in providing financial services and other services.

The partnership programs undertaken by private companies and State-Owned Enterprises (SOEs) on small business run by private persons are very positive in assisting the development of these businesses through the provision of business financing, management coaching, product quality development and marketing, etc. The role of the Government to embrace as many private companies as possible to make small entrepreneurs into partners is highly anticipated.

In line with the increasing economic capability of the small entrepreneurs above, it will have a positive effect on the implementation of tax obligations. It is also expected to foster the interest of the unemployed to do small businesses helping the Government reduce the unemployment rate in Indonesia.

V. CONCLUSION

The imposition of final income tax of 1% of the gross income for individual taxpayers running a business with a gross income not exceeding Rp 4,800,000,000, - in one (1) tax year (small business) does not meet the principles of equality, both horizontal and vertical equality because of the different tax treatment from individuals performing professional services with the same amount of income.

Although the imposition of final income tax is intended to facilitate taxpayers in carrying out their tax obligations, in practice in the field of taxation, it is considered burdensome, especially for individuals who run businesses with a low amount of gross income or new businesses that still experience loss because the imposition of the final income tax does not recognize loss and does not impose taxable income limit. As the result, many taxpayers choose not to carry out tax obligations.

To improve taxpayer compliance in carrying out taxation obligations, it is necessary to improve taxation regulations, as well as other non tax efforts by encouraging small business actors to grow and develop, among others by providing various eases of business starting from the business license, funding, assistance to develop the quality and competitiveness of the product, promotion and marketing assistance and so on

Efforts to improve the handling of tax disputes should be conducted comprehensively starting from upstream to downstream by making improvements at the level of tax audit at the Directorate General of Taxes up to the appeal level. The most important thing is to restore the main function of the fiscus in the Self Assessment system to allow taxpayers to properly perform tax obligations and rights in accordance with the applicable legislation. Furthermore, in carrying out the second function of the fiscus, namely the supervision of compliance of taxpayer obligations through tax audits should be based on the efforts to oversee compliance, not to seek findings in order to achieve state income targets. The important thing that must always be maintained is the balance between the obligations and the rights of taxpayers, and vice versa, because the balance is a demand for the Self Assessment system to run in accordance with the existing concepts.

REFERENCES

- Alink Matthijs and Victor van Kommer (2011), *"Handbook on tax administration"*, IBFD.
- Devereux, Michael P. (1996), *"The Economic of Tax Policy"*, Oxford University Press.
- CNN Indonesia News, November 7th, 2016.
- Goode, Richard (1964), *"The Individual Income Tax"*, Studies of Government Finance, Washington DC: The Brookings Institution.
- Mansury R. (1999), *"Fiscal Policy (Translation Journal Style)"*, Yayasan Pengembangan dan Penyebaran Pengetahuan Perpajakan (YP4).
- Mansury R, *Advanced Income Tax Post Reform 2000 (Translation Journal Style)"*, Yayasan Pengembangan dan Penyebaran Pengetahuan Perpajakan (YP4), 2002.
- Najeeb, Memon (2010), *"How to Tax Small Business in the Informal Economy: A Comparative Analysis of Presumptive Income Tax Design"*, Buletin for International Taxation.
- State Minister for Cooperatives Small and Medium Enterprises of The Republic of Indonesia, Data UMKM online: www.depkop.go.id/berita-informasi/data-umkm
- Tanzi Vito and Milka Casanegra de Jantscher (1987), *"Presumptive Income Taxation: Administrative, Efficiency, and Equity Aspects"*, International Monetary Fund Working Paper.
- Thuronyi, Victor (1996), *"Tax law design and drafting"*, Volume 1, International Monetary Fund.
- World Bank, *"Design Tax System for Micro Small Business: Guide for Practitioners. International Finance Corporation"*. Wahington, 2007.
- Yudkin, Leon, *"A Legal Structure for Effective Income Tax Administration"*, International Tax Program, Harvard Law School, Cambridge, 1971.