

# Tax avoidance and tax evasion: study of taxation implementation in Indonesia

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## Abstract

The conceptual difference between Tax Avoidance and Tax Evasion depends on the legality of the taxpayer's actions. Tax Avoidance is a violation of the law: When taxpayers fail to report their taxable income, they are involved in an illegal activity that makes them liable for administrative or legal action by the authorities. In avoiding taxes, taxpayers are concerned about the possibility of their actions being detected. The objective of this study is to explain the fundamental process differences between Tax Avoidance and Tax Evasion based on a study of tax regulations in Indonesia. To address our research objectives, we conducted a Systematic Literature Review (SLR) of recent Tax Fraud cases ruling, sourced from Supreme Court databases. The results of this study indicate that Tax Avoidance is a practice carried out to reduce the tax burden legally. Although legal and in accordance with regulations, this practice is often considered unethical because it can harm state revenues. In contrast, tax evasion is an illegal act carried out to avoid paying taxes in a manner that violates the law. This can include not reporting all income, falsifying financial statements, or hiding assets. From the perspective of Taxpayers, as long as the tax avoidance is not prohibited, then it is permissible (legal).

Keywords: Tax Avoidance, Tax Evasion, legal, illegal, tax regulations.

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## INTRODUCTION

Taxes are still the largest source of income for the Indonesian state, this is what causes taxes to be considered the backbone of state revenue (Noorprasetya & Prasetya, 2023). In the financial report of the Ministry of Finance of the Republic of Indonesia, the realization of tax revenue each year has not reached the specified target. However, tax revenue each year can be increased to finance facilities to support public welfare. However, not all people are willing to give up some of their money to pay taxes. According to (Hasanah, 2021), people consider taxes to be a burden, so this is what drives taxpayers to try to avoid taxes.

Tax avoidance is an effort made by taxpayers, both individuals and corporations, to minimize the tax burden borne. There are two (2) types of tax avoidance, namely legal tax avoidance (Tax Avoidance) and illegal tax avoidance (Tax Evasion). Tax avoidance is usually carried out by companies by exploiting loopholes in applicable tax laws and regulations. One of the things that encourages companies to carry out tax avoidance is the existence of a self-assessment system adopted by Indonesia. The self-assessment system is a tax collection system that gives taxpayers the authority to calculate their respective tax obligations. This tax system is utilized by taxpayers to minimize the tax burden that must be borne by the company.

The contextual difference between Tax Avoidance and Tax Evasion depends on the legality of the taxpayer's actions. Tax avoidance is a violation of the law: When a taxpayer fails to report taxable income, the taxpayer is involved in an illegal activity that makes him liable for administrative or legal action by the authorities. Tax avoidance, on the other hand, is within the framework of tax law. Tax

avoidance such as exploiting loopholes in tax law to reduce one's tax liability; mapping out possible costs that may arise on a company's assets so that they can be used to reduce income are examples of tax avoidance. In the practice of tax avoidance, the taxpayer has no reason to worry about the possibility of detection; on the contrary, it is often important for him to make detailed statements about his transactions to ensure that the taxpayer obtains the desired tax reduction. If tax avoidance, in this case tax avoidance is legal, what is the difference between avoidance and a reaction to high taxes that arise due to the effect of, for example, higher taxes on financing with equity participation schemes compared to debt. Am I then involved in tax avoidance?

According to James Kessler (1988), in many countries tax avoidance is divided into acceptable tax avoidance and unacceptable tax avoidance. The difference between the two arises from the motivation of the Taxpayer, or from the presence or absence of moral hazard from the Taxpayer. Acceptable tax avoidance is carried out by Taxpayers who have good business objectives, and is carried out in accordance with the objectives of the lawmakers. While the opposite, unacceptable tax avoidance is carried out not in accordance with the objectives of the lawmakers. Thus, tax avoidance can be categorized as a legal activity and can also be categorized as an illegal activity.

This tax burden minimization can also be done in a way that violates tax regulations (unlawful). If tax avoidance is done in ways that are still within the framework of tax regulations, so that it is considered legal because it does not violate tax regulations, then tax evasion or tax smuggling is done in a way that violates tax regulations (illegal), such as by not reporting all sales or increasing costs in a fictitious manner. The objective of this study is to explain the fundamental process differences between Tax Avoidance and Tax Evasion based on a study of tax regulations in Indonesia.

## LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### Definition of Tax Avoidance

Minimizing the tax burden is done by companies by conducting tax planning. Tax planning in a positive sense is defined as planning to fulfill tax obligations completely, correctly, and on time so as to avoid wasting resources. Generalization of tax planning refers to the process of engineering the taxpayer's business and transactions legally so that tax debt or burden is in a minimal amount, or referred to as "tax avoidance". R.A. Mcleod in his article "Tax Avoidance Revisited" states that basically tax avoidance is "any lawful behavior designed to avoid tax", meaning a legally valid action that aims to avoid tax.

Efforts to reduce the tax burden can also be done in a way that violates tax regulations (unlawful), which is called "tax evasion" or tax smuggling. If tax avoidance is done in ways that are still within the framework of tax regulations so that the scheme is considered legitimate (legal) because it does not violate tax regulations, then tax evasion is done in a way that violates tax regulations (illegal), such as by not reporting all sales or increasing costs in a fictitious manner.

### Deductible Expenses

Deductible Expenses are costs that can be deducted as tax deductions. Furthermore, these costs are costs that can be used to obtain, collect and maintain income to be deducted from taxable income or gross income. There are three main principles for determining whether an expense can be classified as deductible expenses:

1. The costs are costs related to business activities
2. The costs are used to obtain taxable income
3. The costs are not used for personal interests.

### Differences between Tax Avoidance and Tax Evasion

In his book entitled "International Tax Primer", Michael J. McIntyre defines tax evasion as an attempt to reduce the tax burden in an illegal manner, usually done by not reporting income or willful deceit. Another author, Zeitlin as quoted by Stef Van Weeghel, states that tax evasion is a serious criminal act and can be subject to criminal sanctions, while tax avoidance is not a criminal act, but is not permitted by the tax authorities. In addition, Frans Vanistendael defines tax evasion (tax evasion or tax fraud) as a violation of tax law, which is punishable by criminal sanctions. Tax evasion consists of clear violations of tax law, such as creating fake accounts or other false documents, creating double bookkeeping (parallel accounts), not reporting income, smuggling or hiding goods or assets owned. The tax consequences of these actions are of course in the form of corrections by the tax administration, but in addition, the perpetrators can also be subject to criminal sanctions.

### Differences between Acceptable Tax Avoidance and Unacceptable Tax Avoidance

According to James Kessler, there are two types of understanding of tax avoidance as also emphasized by Roy Rohatgi in his book "Basic International Taxation", that in many countries tax avoidance is divided into permissible tax avoidance (acceptable tax avoidance/tax planning/tax mitigation) and unacceptable tax avoidance. The form of tax avoidance that is prohibited according to James Kessler is if the Taxpayer's actions are correct according to the "letter of the law", but are incorrect or not in accordance with the intent of the law makers (spirit or intention of the parliament).

### Types of Tax Avoidance Practices

The following will discuss the types of tax avoidance practices that are generally carried out by companies (Nataherwin, 2023) :

1. Transfer Pricing
2. Tax Haven Country
3. Thin Capitalization
4. Treaty Shopping
5. Controlled Foreign Corporation (CFC)

### Theoretical Framework

The theoretical framework of this study is as shown in figure. 1

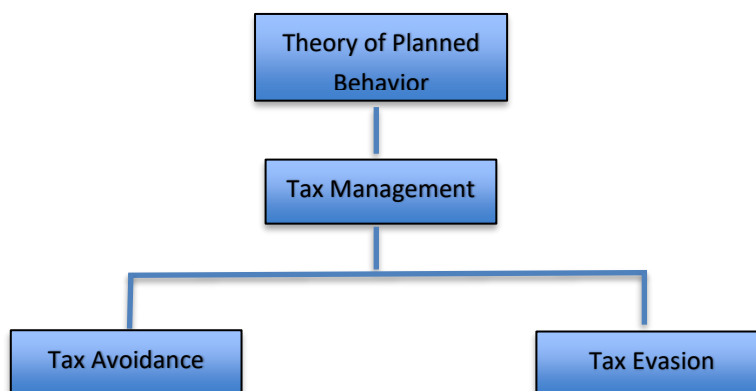


Figure 1. Theoretical framework

## METHODS

The researcher began the process of identifying cases related to tax avoidance practices by collecting several cases of tax avoidance practices in Indonesia. The cases will be collected from Supreme Court of Indonesia. Referring to all the results of the analysis of tax avoidance cases, the researcher conducted a literature review aimed at understanding the process of tax avoidance practices in Indonesia. In addition, the researcher was interested in identifying how the motives for tax avoidance practices were carried out. The case samples used in this study were selected based on tax avoidance practices related to Tax Treaty between 2005-2024. The researcher limited this review by only reviewing cases related to tax avoidance practices and had been found guilty of causing state losses. It was found that there were 5 cases of Supreme Court decisions that caused large state losses and were related to tax treaties.

## RESULT AND DISCUSSION

### 1. Asian Agri Group Case

PT Asian Agri Group, one of the largest palm oil producers in Indonesia, has been involved in tax avoidance practices that have been going on for years. The case began to be revealed in 2006 and involved several affiliated companies operating domestically and abroad. Asian Agri allegedly sold crude palm oil products to affiliated companies abroad at prices below market prices. After that, the products were resold to real buyers at higher prices. This practice resulted in lower reported profits in Indonesia and, as a result, lower taxes paid. AAG is also suspected of creating fictitious costs in its financial statements to suppress taxable profits. This was done by recording expenses that did not correspond to reality.

The case continued to the legal realm after the Directorate General of Taxes (DJP) found strong evidence related to the tax evasion. In 2014, the Supreme Court ruled that AAG must pay a fine of Rp 2.5 trillion as a consequence of tax evasion committed by 14 of their affiliated companies. In addition, AAG is required to pay taxes owed of Rp 1.2 trillion. Asian Agri stated that it was able to pay the fine but made the payments in installments. (Supreme Court Ruling, 2013)

### 2. PT. Adaro Energy Case

Based on an international report from Global Witness released on Thursday, July 4, 2019, PT. Adaro is suspected of transferring its income and profits to its subsidiary Coaltrade Service Internasional in Singapore, through transfer pricing. In this case, transfer pricing is the activity of transferring large amounts of profits in Indonesia to foreign companies, which are tax-free. It can also bring these profits to countries with low tax rates. (globalwitness.org)

Coal mined in Indonesia, sold by PT. Adaro at a lower price to Coaltrade, then resold at a higher price. Bonuses amounting to US\$ 55 million given by third parties and other Adaro subsidiaries were recorded by Coaltrade. The bookkeeping was intended to minimize PT. Adaro's taxes, because the tax rate in Singapore is 17% lower than in Indonesia. The report also stated that through its overseas companies, from 2009-2017 PT. Adaro managed to pay US\$ 125 million (Rp1.75 trillion) in taxes lower than what should have been paid in Indonesia.

### 3. Bentoel International Investama Case

The tax avoidance practice case involving PT Bentoel International Investama Tbk (Bentoel Group), a subsidiary of British American Tobacco (BAT), has attracted public attention and tax authorities. This allegation arose from a report by the Tax Justice Network Institute stating that Bentoel had committed tax avoidance that cost the state up to US\$ 14 million per year. Bentoel took a large loan from a related company in the Netherlands, Rothmans Far East BV, totaling Rp 12 trillion (around US\$ 983 million) between 2013 and 2015. Interest payments on this loan were deductible from income tax in Indonesia. However, the report showed that the funds for

the loan actually came from another BAT group company (Pathway 4) located in Jersey, England, which was intended to avoid tax deductions. Indonesia applied the tax deduction at 20%, but because of an agreement with the Netherlands (Tax Treaty), the tax became 0%. Although in the end Indonesia and the Netherlands revised their agreement by allowing Indonesia to impose a tax of 5%. However, this regulation only came into effect in October 2017, which means that Bentoel has completed its debt interest payment transactions.

#### 4. PT. Indofood Case

The tax avoidance practice case involving PT Indofood Sukses Makmur Tbk (INDF) has become a spotlight because it involves tax avoidance of Rp1.3 billion. This case stems from the company's move to expand by establishing a new subsidiary, namely PT Indofood CBP Sukses Makmur Tbk (ICBP), and transferring assets, liabilities, and operations of the noodle division from INDF to ICBP. In 2015, PT Indofood Sukses Makmur Tbk expanded its business by establishing ICBP. In this process, the company transferred capital and assets from the instant noodle division to ICBP. This action is considered a strategy to reduce the tax obligations that should be paid by INDF. Although this step was taken in the context of business expansion, the Directorate General of Taxes (DJP) still decided that INDF must pay the tax owed of Rp1.3 billion.

The case reached the court and was decided by the Supreme Court through decision No. 117/B/PK/Pjk/2020 on May 13, 2020. In its decision, the Supreme Court rejected INDF's application for a tax reduction on the transfer of land and building rights. The panel of judges emphasized that asset transfer transactions for business expansion purposes are still subject to tax in accordance with applicable provisions. (Supreme Court Ruling, 2020)

#### 5. PT. Unilever Case

PT Unilever Indonesia Tbk is one of the largest companies in the Fast Moving Consumer Goods (FMCG) sector in Indonesia. In 2015, the company was involved in tax avoidance practices that allegedly cost the state up to IDR 800 billion. This tax avoidance was carried out through a transfer pricing mechanism, which is a common practice among multinational companies to shift profits to entities located in jurisdictions with lower tax rates. In 2015, Unilever was reported to have shifted profits through overseas subsidiaries and utilized transfer pricing policies to reduce product acquisition costs. In this way, they managed to reduce the tax burden by IDR 800 billion, which had a direct impact on state tax revenues.

This case literature review has explored the motives from the taxpayer perspectives on Tax Avoidance Practices.. Our primary aim is to examine the extent to which these motivations aid in revealing tax evasion and avoidance, while simultaneously fostering greater compliance among taxpayers. Our analysis has revealed that the main difference between tax avoidance and tax evasion practices lies in the motives of taxpayers's perspectives. As (Freedman, 2018) notes, excessive information may obscure and may even become a smokescreen to disguise company activities. This study is in line with (Bird & Davis-Nozemack, 2018) that 'under this view, tax avoidance represents a socially irresponsible practice that is inconsistent with a firm's obligations to society'.

## CONCLUSION

This paper identifies that the main difference between tax avoidance and tax evasion practices lies in the motives of taxpayers. From the taxpayer's perspective, they generally assume that there are no tax violation practices that are carried out by violating tax laws. On the other hand, the tax authorities review tax avoidance practices in Indonesia and determine several tax avoidance practices that are classified as tax evasion practices. There is no definition of tax avoidance, tax evasion, acceptable tax avoidance and unacceptable tax avoidance in the Law on Income Tax (UU PPh), either since the

enactment of Law Number 7 of 1983, or in its amendments, namely Law Number 7 of 1991, which was later amended by Law Number 10 of 1994, Law Number 17 of 2000, and the latest amendment, namely Law Number 36 of 2008, thus giving rise to different interpretations between Taxpayers and tax authorities. Taxpayers and tax authorities will provide their own interpretations, so that there is no legal certainty. From the Taxpayer's point of view, they will argue that as long as the tax avoidance they are carrying out is not prohibited, then it is legitimate.

Therefore, we encourage future research to explore this path to help examine the differences in tax avoidance so as to produce a real idea of tax avoidance practices especially in Indonesia. The sample cases of tax avoidance practices in this study can be expanded by accessing the official website of the Supreme Court Directory.

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