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# Reducing Socio-economic Disparities in Indonesia: Strengthening the Taxation Sector in Indonesia

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## Abstract

This legal research aims to analyze the strengthening of the tax sector in Indonesia to overcome the socio-economic disparities in the era of the Industrial Revolution 4.0. The research methodology used is descriptive qualitative research using a normative legal approach and documentary data collection techniques. The research model focuses on analyzing tax policy and related literature to understand the problem and provide solutions to address the problem. This research identifies tax evasion and corruption in the tax sector as the main factors contributing to Indonesia's low tax revenue. This research suggests that tax law reform and institutional transformation are needed to strengthen the capacity of tax institutions and improve tax administration, human resources, and information technology infrastructure to increase tax revenue and reduce tax evasion practices. Increased public confidence in the tax system can improve tax fairness and equity at all levels of society.

**Keywords:** tax sector; socio-economic disparities; well-being

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## Introduction

As the world enters the era of the Industrial Revolution 4.0, a number of efforts are being made to create a more just and prosperous society. Support from all levels of society and government is needed to ensure that the process of developing in this era goes well (Rahmandani & Samsuri, 2019). Heywood (1994) describes the support from all levels of society and all government apparatuses as a mutual relationship. This understanding means that, on the one hand, citizens are the subjects who are the reason why the state is formed, and, on the other hand, the state is made up of the rights and duties of each individual. The rights and duties of each individual in the state can be related to the legal provisions established in the 1945 Constitution of the Republic of Indonesia. These are better known as the rights and duties of citizens. If we look more closely, it is in Law 12 of 2006 on Citizenship (Citizenship Law) that we find the meaning of citizen from a legal perspective. The Nationality Law stipulates that Indonesian citizens are indigenous Indonesians and people of other nationalities legally recognised as citizens. Consequently, anyone exercising the rights and duties of nationality should do so in accordance with this rule.

The rights and duties of the state are also inseparable from the fulfillment of the rights and duties of citizens. From the citizens' point of view, rights are general obligations to the state and vice versa. Failure to fulfill the obligations of citizens will also result in the disturbance of the rights of other citizens. In this case, for example, this leads to the problem of disparity between regions in Indonesia (Febriansyah, 2017; Rosana, 2016). The first paragraph of Section 34 of the 1945 Constitution expressly states that the State's responsibility is to take care of destitute or neglected children. This mandate clearly and unequivocally confirms that the problem of poverty is one of the main issues that must become the country's development program. In addition, the fourth paragraph of the preamble to the 1945 Constitution explicitly states the purpose of establishing the Indonesian state government. One of the objectives is to promote the general welfare and achieve social justice for all Indonesian people. This objective means that the government must create and promote prosperity for the people, but it must be accompanied by the principle of justice for all people wherever they are in Indonesia, from Sabang to Marauke. Achieving community welfare requires a process called development and growth (Ginting, 2016).

The community's well-being is a situation in which the basic needs and the community's social, economic, and cultural rights are well met (Costanza et al., 2007; Lee et al., 2015). As the public authority, the State is obliged to provide for the community's welfare. The State must create conditions enabling people to achieve well-being, especially those of the disadvantaged (Warren et al., 2001). The State must develop public policies to meet people's needs and improve their welfare. One way in which the State can achieve people's well-being is by providing better access to health services, education, and decent work (Frota, 2008; Lawson, 2005). The State must ensure that these services are available and accessible to all people without exception. The State must also protect human rights and protect people from all forms of violence and discrimination (Hammarberg, 2009; Malik et al., 2021). The State must respect the rights of minorities and ensure that they enjoy the same prosperity as the majority. In addition, the State must build adequate infrastructure to promote economic growth and improve people's welfare (Bungin, 2018; Rachbini & Abdulah, 2020). The State must pay attention to the distribution of wealth and ensure that all people can benefit from economic growth. The State must also develop sustainable environmental policies to ensure people's well-being in the future. The State must ensure that natural resources are used efficiently and responsibly to ensure the survival of society (Jazuli, 2015; Nst, 2020). The State must cooperate with various parties, including the private sector and civil society, to achieve better public welfare. The State must also pay attention to the aspirations and participation of the community in the development process. Community welfare is the State's responsibility and the community's shared responsibility. Communities must actively participate in the development and fight for their rights. The community must also act as a watchdog and partner in the implementation of development programs (Epakartika et al., 2019; Mansuri & Rao, 2012).

The greatest challenge in achieving community well-being is how government can ensure that all people have equal opportunities in life. This is not easy because social, economic, and cultural factors affect people's well-being. The state has to pay attention to the differences and inequalities in society and try to solve the problems. An obstacle often faced by the state is the limited resources available. The state must prioritize using existing resources to meet society's basic needs. The state must pay attention to basic needs such as access to health, education, and decent work. In this paper, the author tries to use an approach from the financial side of the state, namely taxes as an instrument of the state to achieve the goals of the state as stated in the preamble of the 1945 Constitution, to answer the previous problem of inequality. One of the duties of citizens, as stipulated in Article 23A of the 1945 Constitution, is to pay taxes. According to Rohendi (2014), one of the functions of taxes is budgetary. The budgeting function can be interpreted as the function of taxes used to finance government expenditures to achieve development goals, both in terms of human resources and infrastructure in various sectors. Although the nature of taxes according to the law does not provide direct reciprocity, the collection of taxes based on citizens' voluntary compliance can realize the state's ideals and goals in development. The state's goal in human resource development is reflected in the preamble of the 1945 Constitution, namely, to educate the nation's life. The development goals in various sectors also manifest the state's goal to promote the general welfare. The study aims to conceptualize the rights and obligations of the people and the state in addressing social and economic disparities in Indonesia. The duties of citizens, in this case, are to pay taxes, while the rights of citizens are general welfare. The synergy between citizens and the state is necessary to achieve the country's welfare and progress.

## Materials and Methods

In carrying out this research, the researchers used descriptive qualitative research. Qualitative descriptive research is a research method that aims to describe a phenomenon in detail and in-depth (Bradshaw et al., 2017; Williams, 2007). The approach is normative legal research using a literature review and existing legislation. Normative legal research is a type of research that aims to analyze the legal rules relating to a problem or phenomenon in the field of law (Purwati, 2020; Tan, 2021). In normative legal research in the field of tax, researchers will analyze laws and regulations relating to tax and other related regulations. This research makes use of various available documents. Primary and secondary legal materials are used in this research. Using primary legal materials, the researchers can study the articles of the 1945 Constitution relating to taxes and related laws. In collecting secondary legal materials, researchers can use academic journals recognized for their validity and relevance to the research topic. In addition, researchers can use reference books and articles that discuss taxation in Indonesia and its challenges.

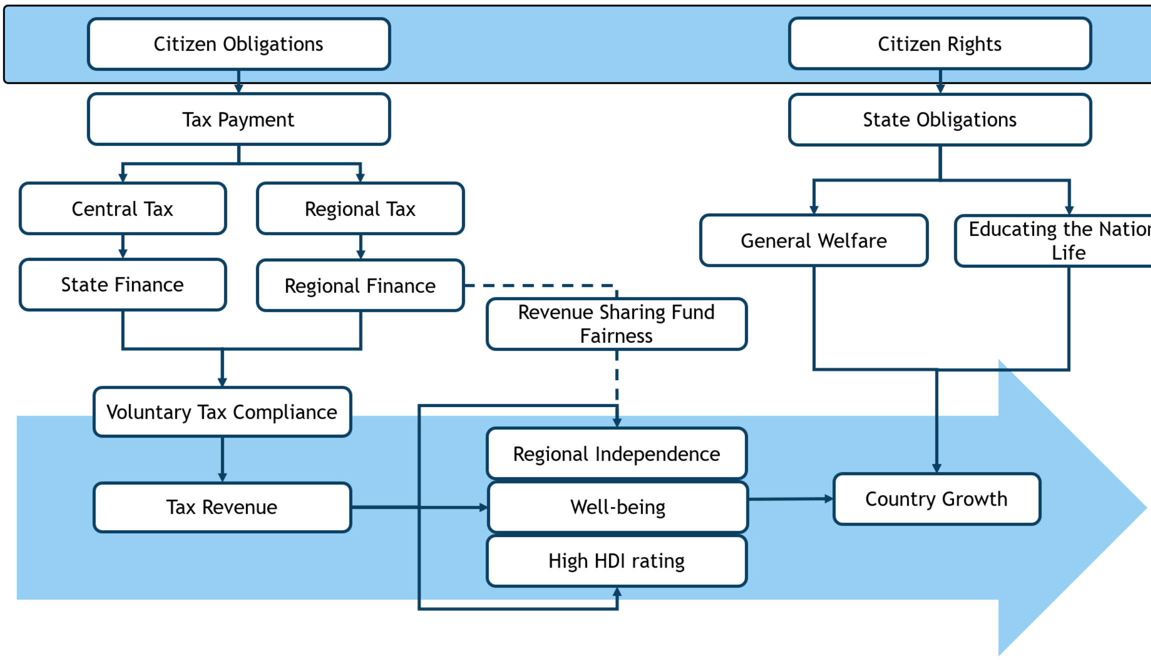
When conducting descriptive qualitative research, researchers use documentary data collection techniques. After data collection, researchers can analyze the data systematically and in-depth to answer the research questions. This research uses a conceptual research model that aims to provide an in-depth understanding and analysis of the strengthening of the taxation sector in Indonesia in overcoming socio-economic inequality. In this research, we will collect data and information on taxation policies implemented in Indonesia and related literature to understand the issue better. Then, the collected data and information will be critically and comprehensively analyzed to find the best solution to strengthening the taxation sector in Indonesia to address socio-economic inequality. Qualitative descriptive analysis will be used to understand the problem and seek solutions in a holistic and integrated manner.

## Results and Discussion

### *Conceptual Framework of the Relationship Between Citizens, Taxes, and Development*

The community's well-being is achieved when its fundamental needs and social, economic, and cultural rights are addressed. As the public authority, the State must ensure the community's welfare (Jamil, 2021; Jenson, 2017). Especially for those who are underprivileged, it is the responsibility of the State to foster situations that promote happiness. The State must adopt public policies that meet people's needs and improve their welfare (Ardinata, 2020; Jimenez et al., 2014; Maruti, 2021). Providing improved access to health services, education, and respectable work is one way the State may promote the well-being of its citizens. The government must ensure these services are provided and accessible to all citizens. The State must also guarantee human rights and safeguard individuals from violence and prejudice (Ardinata, 2020; Black, 2008). The State must respect minority rights and ensure they experience the same prosperity as the majority. Also, the State must construct enough infrastructure to foster economic growth and improve the welfare of its citizens (Siregar, 2018; Utami & Indrajaya, 2019). The State must pay attention to the distribution of wealth and ensure that everyone benefits from economic expansion. To safeguard the future well-being of its citizens, the State must also create sustainable environmental policies. To maintain the existence of society, the State must ensure the efficient and responsible use of natural resources. The State must collaborate with several groups, including the commercial sector and civil society, to improve public welfare. The State must also consider community ambitions and engagement in the development process. The community's welfare is the State's responsibility and shared community responsibility. Communities must actively engage in development and advocate for their rights. The community must also serve as a watchdog and a partner in implementing development programs. Schematically, the relationship between citizens, taxes and development can be seen in the following figure.

Figure 1 The Relationship Between Citizens, Taxes, and Development.




Source: Processed by the author

The relationship between central and local finance is crucial to ensuring balanced and equitable development across Indonesia. Central and regional finances closely relate to achieving national development goals and improving people's welfare. The financial relationship between the central and local governments is regulated by the Law of the Republic of Indonesia No. 1 of 2022 on the Financial Relationship between the Central Government and Local Governments (HKPD Law). In Article 1 of the HKPD Law, the financial relationship between the central government and local governments is defined as

> *"a system of financial management that regulates the financial rights and obligations between the central government and local governments that are implemented in a fair, transparent, accountable and harmonized manner based on the law".*

The central government is responsible for ensuring that local finances receive adequate support to implement development programs and improve the welfare of the people in the regions (Said, 2015; Wibawa, 2019). Local government, in turn, is responsible for using the funds it receives from the central government effectively and efficiently to benefit the community. Strong regional finances are essential for increasing regional independence. With solid finances, regions can obtain sufficient resources to implement development programs that meet local needs and potential. Strong regional finances also enable regions to cope with emerging financial and economic problems and reduce their dependence on the central government for funding. Strong local finances can also improve the quality of public services so that people feel the benefits of the development undertaken by local governments. Therefore, the central government needs to provide adequate support for local finances, for example, by providing transfers to the regions and sharing resources equitably. Local governments also need to manage their finances well to use the funds they receive effectively and efficiently to benefit the community and increase regional independence. Thus, a solid central-local financial relationship and strong regional finances will go a long way toward achieving development goals and community welfare equitably and sustainably throughout Indonesia.

Voluntarily paid taxes will positively affect state and local finances from the point of view of citizens' obligations. This achievement will have an impact on the implementation of the state's obligations in fulfilling the rights of its citizens to promote the general welfare and educate the nation's life. Success in educating the nation's life has implications for raising Indonesian citizens' Human Development Index (HDI) (Lind, 2019; Maqin & Sidharta, 2017; Shah, 2016). A high HDI will make Indonesians more reliable and agile in responding to development challenges. According to Hasan & Azis (2018), this can achieve each region's independence in Indonesia. Thus, according to the author, this independence will solve inequality in various fields between regions in Indonesia. In the short term, the state's task in solving development inequality is to realize a system of revenue-sharing funds for state finances that is fair to all regions in Indonesia. Revenue-sharing funds manifest the state's obligation to provide equity and wealth distribution for its citizens. Thus, tax as an instrument to overcome inequality will realize the country's progress and the citizens' welfare as a result of the balance of rights and duties in the state between the state and its citizens.

### *The Juridical Basis of the Obligation to Pay Taxes*

The basic provisions for tax collection in Indonesia are set out in the 1945 Constitution. The collection of taxes in Indonesia is so important that it has to be stipulated in the basic provisions of the 1945 Constitution, namely Article 23. Initially, the provision of tax collection was stated in Article 23 (2) of the 1945 Constitution, which stated that "all taxes for state purposes shall be based on the law". However, after the third amendment of the 1945 Constitution, the provision is stated in Article 23A, which reads: "Taxes and dues of a compulsory nature shall be regulated by law". There is a change in the basic regulation of tax collection, which was originally based on the law, after the third amendment of the 1945 Constitution became regulated by law. This change means that before the amendment, Article 23(2) of the 1945 Constitution allowed tax levies not to be determined by law to the extent delegated by law. After the amendment, tax levies regulated by law can only be delegated to legislation.

Tax legislation consists of two parts: substantive tax law and formal tax law. Material tax law regulates what is subject to tax, who must pay tax, how the amount of tax is calculated, and what tax exemptions are available. Formal tax law, on the other hand, regulates the procedures and processes for the implementation of tax payments, including registration, reporting, collection and resolution of tax disputes. Material tax law plays an important role in determining the rights and obligations of taxpayers. In general, substantive tax law regulates the types of existing taxes, such as income tax, value added tax, and land and building tax, as well as other tax-related provisions, such as tax rates, tax collection, and tax exemptions. On the other hand, formal tax law sets out the rules for the implementation and enforcement of tax laws. Formal tax law covers aspects such as administrative taxation, tax payment procedures, investigations and the resolution of tax disputes. It aims to ensure taxpayer compliance and provide legal certainty in the implementation of tax procedures. Although substantive and formal tax laws are separate, they are interrelated and influence each other. The substantive tax law determines who must pay tax and how much tax must be paid, while the formal tax law determines how the tax must be paid. Violation of substantive tax law may result in criminal sanctions, while violation of formal tax law may result in administrative sanctions.

In the context of regulation in Indonesia, formal tax law is governed by Law No. 6 of 1983 on General Provisions and Tax Procedures as amended by Law No. 7 of 2021 on Harmonisation of Tax Regulations (KUP Law). Article 1(1) of the KUP Law defines tax as follows.

> *"compulsory contribution to the state owed by individuals or entities that are compelling based on the Act, with no direct reward and used for state purposes for the greatest prosperity of the people."*

This contribution must be made to the state without receiving anything in return. The taxes collected are used to finance various government needs, including improving the welfare of the people. The main purpose of taxes is to ensure that the government has sufficient resources to provide various public services and meet the basic needs of the people. Taxes are therefore one of the main sources of government revenue and an important part of building a strong and sustainable state.

***Impact of Tax Revenue on Socio-Economic Inequality***

Failure to maximize tax revenues can have a significant impact on socio-economic inequality (Mehrara & Farahani, 2016; Olaoye et al., 2019). The consequences can be seen in several aspects that affect people's well-being:

1. Income inequality between communities can widen the socio-economic gap. Tax revenues that are not maximized result in limited resources to fund social programs, such as providing social assistance to needy people. This situation will worsen the socio-economic conditions of people in need.
2. Infrastructure development and other development programs are also disrupted due to limited resources. Low tax revenues may limit infrastructure development, education, health, and other socio-economic programs. This will widen the socio-economic gap between people in urban and rural areas.
3. The government's financial management could be more relaxed about failing to maximize tax revenue.

The government needs help to finance strategic projects that require large budgets. This condition affects investment uncertainty and Indonesia's competitiveness in the global market. In conclusion, sub-optimal tax revenue can significantly impact socio-economic inequality. Therefore, efforts by the government and society are needed to increase awareness of tax payments and reduce tax avoidance practices and corruption. This will help increase tax revenue, which can fund socio-economic programs that benefit all Indonesians.

Substantial or high tax revenues can positively impact a country's economy, particularly in reducing economic and social inequality. With sufficient tax revenue, the government can improve people's welfare by building better infrastructure, providing better quality public services, and increasing the availability of education and health care. High tax revenues can also strengthen the country's financial system and improve economic performance. On the other hand, low tax revenues can make it difficult for governments to meet people's basic needs, especially the less well-off. Economic and social inequality can be exacerbated if the state struggles to build the necessary infrastructure, improve public services and raise the quality of education and health. This can exacerbate social and economic disparities between different groups of people. In the Indonesian context, low tax revenues are one of the factors that exacerbate economic and social inequality. Although Indonesia has significant tax potential, there is still a high level of tax evasion and budget leakage, resulting in low tax revenues. This makes it difficult for the state to meet the basic needs of society, such as education, health, and adequate infrastructure.

### *Taxation Challenges in Indonesia*

One of the main reasons for Indonesia's low tax revenue is the high level of tax avoidance (Safuan et al., 2022; Wijaya & Rahayu, 2021). Tax avoidance occurs when a person or company avoids paying taxes in a way not by applicable laws and regulations. This can be through legal loopholes, transfer pricing or other unethical actions (Dowling, 2014; Gunn, 1977; Hansen et al., 1992; Payne & Raiborn, 2018). In addition, corruption in the tax sector is also one factor affecting Indonesia's low tax revenue (Amah et al., 2023; Patty, 2015; Widiastuti, 2018). Corruption can take various forms, such as accepting bribes or gratuities by tax officials, falsifying documents, or abusing authority in conducting tax audits. Corruption harms government finances and creates inequity in the tax system, which harms public confidence in the existing tax system. Corruption in the tax sector significantly impacts public confidence in the tax system. People tend to perceive injustice when they see that some people or companies avoid paying taxes or even get tax breaks through corrupt practices. This can reduce people's trust in the government and the tax system and make them less likely to comply with tax rules.

Several studies show that corruption in the tax sector can significantly reduce tax revenues, which can affect public finances and economic development (Epaphra & Massawe, 2017; Imam & Jacobs, 2014). In addition, corruption can distort tax equity and favor groups with access to tax decision-making, such as large corporations and wealthy individuals. Therefore, the government must strengthen oversight and legal action against corrupt practices in the tax sector to restore public confidence. Increased tax administration and collection transparency can also help build public trust in the tax system. In the long run, solid public confidence in taxation can help increase tax revenues and promote tax fairness and equity at all levels of society.

In addition to tax evasion and corruption, other factors contribute to Indonesia's low tax revenues, such as weak tax administration, lack of public awareness of the importance of paying taxes, and low quality of tax services. To increase tax revenue in Indonesia, efforts must be made to overcome tax evasion and corruption in the tax sector. This can be done by strictly enforcing the law against tax evasion and corruption perpetrators and increasing transparency and accountability in the tax system. In addition, the government must raise public awareness of the importance of paying taxes and provide better and more efficient tax services. Therefore, tax law reform is significant in closing legal loopholes to avoid paying taxes. Such reforms can be carried out through changes in tax regulations, stricter law enforcement, and the development of information technology that can monitor tax activities more effectively. Institutional change is also urgently needed to strengthen the capacity of tax institutions to deal with tax evasion. This transformation can be achieved by improving tax administration, improving the quality of human resources in the tax sector, and developing information technology infrastructure that can support the collection and analysis of tax data more accurately and effectively. With tax law reform and institutional transformation, tax revenues in Indonesia are expected to increase significantly, and tax avoidance practices will be reduced. This will positively impact economic development and public welfare in general.

## Conclusion

The legal basis for tax payment in Indonesia is regulated in the 1945 Constitution. Tax collection is so crucial in Indonesia that it is enshrined in the essential constitution in Article 23. The initial provisions of tax collection were stated in Article 23, paragraph (2) of the 1945 Constitution, which declares that "all taxes for the benefit of the state are based on the law". However, after the third amendment to the 1945 Constitution, the provision was stated in Article 23A, which reads, "taxes and levies are coercive and regulated by the law." This change indicates that the tax collection, which was initially based on the law, is now regulated by law. Tax revenue plays a significant role in addressing socio-economic disparities in Indonesia. However, there are challenges to tax revenue in Indonesia. Tax revenue in Indonesia must be higher due to high tax evasion and corruption in the taxation sector. Tax avoidance occurs through legal loopholes, transfer pricing, and unethical actions. Corruption can be bribery, document forgery, and abuse of authority. Corruption in the tax sector harms state finances and creates injustice in the tax system, reducing public confidence in the tax system. Government efforts to strengthen supervision, legal action, and transparency can help increase public confidence in taxation. Other factors affecting low tax revenue in Indonesia are weak tax governance, lack of public awareness, and low quality of service in the tax sector. Therefore, efforts are needed to address tax evasion and corruption, increase public awareness, and provide better services in the tax sector to increase tax revenue in Indonesia. Tax law reform and institutional transformation are needed to support the increase of tax revenue in Indonesia.

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