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Abstract

This study examined the effect of the changes in tax rates introduced by the latest Indonesian tax reform of 2008/2009 on the growth rate of taxpayer's reported income between 2008 and 2011. The reform reduced the marginal tax rates for most income groups and raised the exemptions. The reduction in tax rates was a subsequent policy after the Indonesian government granted a small tax amnesty, called the "sunset policy" program. We analyzed individual tax return data, focusing on Jakarta Province tax offices which are the largest contributors to Indonesian tax collection. This study found that the reduction in tax rates had a positive effect on the overall samples. The elasticity (uncompensated) of Adjusted Gross Income with respect to the marginal net-of-tax rate for overall sample lay between 0.14 and 0.18. Further, this elasticity was driven by responses of labor/ employee taxpayers as the elasticity for self-employed taxpayers was insignificant. The elasticity tended to be higher for the high-income taxpayers. We found that taxpayers who earned more than IDR200 Million in 2008 (the upper 16% of income distribution) had an elasticity of 0.42. We also found that after controlling the effect of tax rates and other determinants of income growth, the participants of tax amnesty had 2% to 3% higher growth rate of reported income when compared to nonparticipants. However, the effect of tax rate cut was insignificant for tax amnesty participants. Tax enforcements and difference in perceptions between the two groups in viewing the tax system were among the reasons for the higher growth rate. The results from this study could become a consideration for the government when they formulate policies to raise the tax collection.