Qualitative Analysis of the Implementation of Msme's Income Tax: Is It on Target or Is It a Loophole for Tax Avoidance?

Siti Noor Aini Hidayah[1,] Alan Afriyanto[2]

[1] Diponegoro University, Semarang, Indonesia
[2] Ministry of Finance, Jakarta, Indonesia
sitinoorainihidayah@lecturer.undip.ac.id

Abstract. This study aims to evaluate the implementation of MSME's income tax policy in Indonesia. Using qualitative case study approach, this research collected data throught in-depth interviews, observations, and documentatios analysis conducted at the Directorate of Potential, Compliance, and Revenue of the Directorate General of Taxes. Our findings reveal three major issues. First, MSME income tax scheme has been widely misused by large business through firm splitting practices to benefit from lower tax rates. Second, turnover threshold of IDR500 million has created a monitoring gap and reduced the number of taxpayers making payments. Lastly, limited period eligibility for individual MSME creates inequity and administrative burdens for small business that have not yet grown beyond MSME scale. This study proposes several policy improvements to address these issues. Some of these recommendations include limiting the use of MSME tax facilities for business entities, utilizing e-commerce data integration and assigning digital platforms as tax collectors, and allowing lifetime use of MSME tax scheme for eligible individual taxpayers.

Keywords: MSME Taxation, Tax Policy, Tax Compliance.

1 Introduction

In Indonesia's revenue over the past five years has depended on tax revenue, with over 70% of state revenue coming from the tax sector [1]. One business sector with significant potential for state revenue is the micro, small, and medium enterprise (MSME) sector. MSMEs contribute significantly to Indonesia's Gross Domestic Product (GDP). According to the Ministry of MSMEs, in 2023, MSMEs contributed IDR9,580 trillion to Indonesia's GDP, or approximately 61% of the country's total GDP. Furthermore, according to the Coordinating Ministry for Economic Affairs, MSMEs dominate business units in Indonesia, accounting for 99.99% of the total [2].

One of the steps taken by the government through the Directorate General of Taxes (DGT) to increase voluntary compliance of MSMEs, which have enormous tax potential, is by providing tax incentives [3]. One such incentive for MSMEs is to simplify the calculation of Income Tax payments and with a tax rate much lower than the general

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rate, namely by implementing Government Regulation Number 46 of 2013 [4]. Through PP 46, Taxpayers with business turnover of up to IDR4.8 billion, known as MSME Taxpayers, are subject to an Income Tax rate of only 1% of business turnover each month.

In 2018, to further ease the burden on MSME taxpayers and improve MSME taxpayer compliance, the tax rate was reduced to only 0.5% of monthly business turnover through the implementation of Government Regulation Number 23 of 2018 [5, 6]. PP 23 is still considered burdensome for MSME business actors because regardless of the size of their business turnover, they are still subject to MSME Income Tax at a rate of 0.5%. For example, if a MSME only has a business turnover of IDR500 thousand in one month, it will still be subject to a MSME Income Tax rate of 0.5%. Due to this problem, the government revoked PP 23 and replaced it with Government Regulation Number 55 of 2022 [7, 8]. In PP 55, the MSME Income Tax rate remains at 0.5% but adds a threshold, which is imposed only on business actors with a business turnover in one fiscal year of more than IDR500 million.

Although the government has provided incentives in the form of MSME Income Tax for MSME taxpayers since 2013, this has not been able to increase the tax ratio. For the past 10 years, Indonesia's tax ratio has remained stagnant at around 10% [10, 11]. This figure is still below the average tax ratio of ASEAN countries, which is around 15% [11-13]. Furthermore, according to internal DGT data, corporate MSME taxpayers, which serve as an example of individual taxpayer compliance, have seen a decline in tax compliance levels year after year. The following graph shows the number of corporate MSME taxpayers and the number of those who filed Annual Tax Returns for the 2018 to 2022 fiscal years.

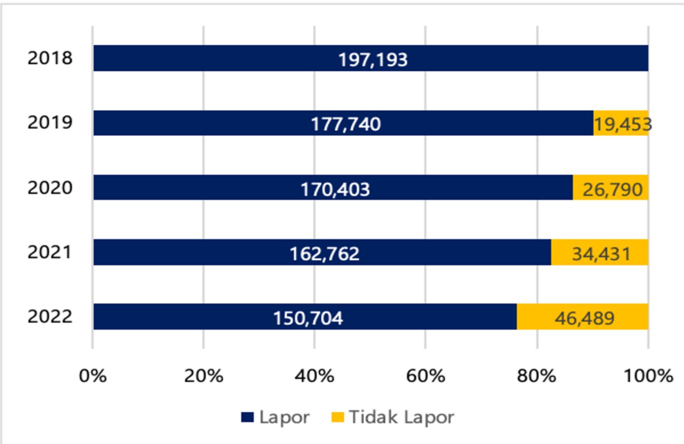

Fig. 1. Number of MSME corporate taxpayers and the number of those reporting annual tax returns for tax years 2018 to 2022.
Source: Internal DGT data processed by the author.

Based on Fig. 1, the number of corporate taxpayers registering to use the MSME Income Tax continues to increase. However, the number of taxpayers filing annual tax returns continues to decline. The highest decline in annual tax returns occurred in the 2019 tax year, reaching 9.8%.

Previous studies have shown that inappropriately targeted tax incentives can increase the risk of tax evasion. Research by Mayaningsih et al., (2023) states that taxpayers often evade taxes by exploiting existing legal loopholes [14]. For example, they may use incentives they shouldn't receive, exploit threshold loopholes, or differing rates. Research by Afriyanto & Hidayah, (2025) also explains that the high threshold for Taxable Entrepreneurs (IDR4.8 billion) makes it very easy for taxpayers to evade taxes to avoid collecting Value Added Tax [13].

Extensive research has been conducted on MSME tax incentives. Palupi & Arifin, (2023) explain that various internal and external factors can influence MSME taxpayer compliance, such as service and convenience [7]. Putri et al., (2024) state that Income Tax incentives have a significant positive effect on taxpayer compliance [15]. Although tax digitalization does not significantly moderate the relationship between compliance and tax digitalization, it still plays a moderating role in the influence of Income Tax incentives on compliance.

Furthermore, research by Alam et al., (2025) explains that the reduction in the MSME Income Tax rate from 1% to 0.5% has a positive impact on taxpayers, but assistance is still needed to improve taxpayer compliance [16]. Research by Yanto et al., (2025) explains that MSME tax policies have a positive impact on MSME growth [17]. These studies have interesting results, primarily related to the MSME Income Tax policy to increase MSME growth and its impact on MSME taxpayer compliance. However, several previous studies have not evaluated the implementation of the MSME Income Tax. Is it right on target for MSMEs or will this regulation open a huge gap for tax avoidance practices? This is questionable because since its implementation from 2013 until now, MSME taxpayer compliance has not increased and has not been able to increase Indonesia's tax ratio.

This study aims to examine the implementation, proposed improvements, and potential tax revenue. First, this study will evaluate the implementation of MSME Income Tax to determine whether it has been optimal and properly targeted. Second, this study will describe the proposed improvements in the implementation of MSME Income Tax. Third, this study will explain the potential additional tax revenue and the potential increase in the number of Taxable Entrepreneurs resulting from the implementation of the proposed improvements.

2 Literature Review

2.1 Tax Compliance Theory

Tax compliance is the behavior reflected by taxpayers in fulfilling their tax obligations in accordance with applicable regulations. Tax compliance increases when the authorities are fair and supportive, reinforced by the optimal use of tax revenues to fund public services [18]. Furthermore, experiences of unfairness during audits can reduce tax compliance [19].

Based on the slippery slope framework, several instruments exist to improve tax compliance. Tax compliance will be improved through forced audits and fines, as well as alternative approaches such as regulations, incentives, participation, fairness, and service support [20]. In other words, the slippery slope framework explains that the level of tax compliance is formed by a combination of the power of the tax authority and the level of taxpayer trust.

2.2 Tax Income Policy for MSME

Through PP 55, the government stipulates three tax periods for the imposition of a final income tax of 0.5%. First, the final income tax for MSMEs is valid for a maximum of seven years for individual taxpayers. Second, it is valid for a maximum of four years for corporate taxpayers in the form of cooperatives, limited partnerships, firms, village-owned enterprises, or sole proprietorships established by a single individual. Third, it is valid for a maximum of three tax years for corporate taxpayers in the form of limited liability companies. These tax periods begin with the enactment of PP 23.

The provisions on final income tax for MSMEs will be revised through PP 55. In this revised regulation, the government will remove the deadline for utilizing final income tax for MSMEs for individual taxpayers and corporate taxpayers. In other words, Income Tax for MSMEs will apply permanently to individual taxpayers conducting business activities with a gross turnover of no more than IDR4.8 billion per year.

3 Methodology

This research uses qualitative methods. According to Creswell, (2016: 168), qualitative research essentially aims to explore the main phenomenon, often referred to as the central phenomenon, in a study [21]. This method was used in this study to deeply explore the specific problems associated with the implementation of MSME Income Tax in Indonesia. The research design employed a case study approach. According to Creswell, (2014: 35) and Creswell (2016: 22), a case study is a research design primarily used for evaluation purposes [21, 22]. This method is expected to allow for a more in-depth evaluation of the implementation of Income Tax on MSMEs in Indonesia.

The research location used in this study was the Directorate of Potential, Compliance, and Revenue (PKP). One of the duties and functions of the PKP Directorate, as stipulated in Minister of Finance Regulation Number 124 of 2024 concerning the Organization and Work Procedures of the Ministry of Finance, is to implement policies related to taxpayer compliance. All DGT vertical offices will report their level of compliance and various obstacles related to the implementation of regulations, including PP 55, to the PKP Directorate. Based on this, the PKP was selected as the research location.

The data collection techniques used in this study refer to Creswell (2016: 266), which consist of three strategies: qualitative observation, in-depth interviews, and documentation studies. Qualitative observations were conducted by the researcher to record and collect necessary data. Observations will take place from January 2026 to February 2026. All observation activities will be conducted at the PKP Directorate.

In-depth interviews will be conducted by the researcher to obtain complete and in-depth information. The interviews will be held from January 2026 to February 2026. This study identified informants to obtain information and data related to the effectiveness of the implementation of Income Tax for MSMEs, as well as various obstacles and solutions for improvement. The researcher selected five informants. The following is a detailed list of informants.

(i). Informant 1 is a Functional Official in the Policy Impact Subdirectorate. Functional Officials in the Policy Impact Subdirectorate are assigned the code PF 1.
(ii). Informant 2 is a Functional Official in the Taxpayer Compliance Risk and Data Science Subdirectorate. Functional Officials in the Taxpayer Compliance Risk and Data Science Subdirectorate are assigned the code PF 2.
(iii). Informant 3 is an Echelon IV Official in the Regional Taxpayer Supervision Section at the Primary Tax Service Office. Echelon IV Officials in the Regional Taxpayer Supervision Section at the Primary Tax Service Office are assigned the code PF 3.
(iv). Informant 4 is an Account Representative in the Regional Taxpayer Supervision Section at the Primary Tax Service Office. Account Representatives in the Regional Taxpayer Supervision Section at the Primary Tax Service Office are assigned the code PF 4.
(v). Informant 5 is a Taxation Lecturer at the Yogyakarta State University. Taxation lecturer at the Yogyakarta State University was assigned the code PF 5.

The researcher identified five informants based on the research questions to be answered. Functional Officials in the Policy Impact Sub-Directorate play a leading role in monitoring MSME taxpayer compliance nationally. Functional Officials in the Taxpayer Compliance Risk and Data Science Sub-Directorate are responsible for collecting data related to potential non-compliance with regulations. Echelon IV officials in the Regional Taxpayer Supervision Section at the Primary Tax Service Office lead the supervision of MSME taxpayer compliance at the smallest DGT vertical unit. Account Representatives in the Regional Taxpayer Supervision Section at the Primary Tax Service Office actively supervise MSME taxpayer compliance at the smallest DGT vertical unit. Taxation lecturers at the Yogyakarta State University possess extensive theoretical knowledge related to the implementation of tax policies.

The transcribed interview results were analyzed using open coding and axial coding techniques. NVIVO 12 Plus software was used to facilitate the coding process. Open coding in this study was conducted by inventorying concepts or ideas sourced from informants into specific codes (nodes). Next, axial coding was carried out by grouping, connecting, and quantifying each node into categories.

The interactive analysis model is an analytical technique that includes data reduction, data presentation, and verification or drawing conclusions. These three steps are carried out simultaneously and interactively throughout the research process. As illustrated in Fig. 2, the components of data collection, data reduction, data presentation, and conclusion drawing are interconnected, forming a continous cycle within the interactive analysis model.

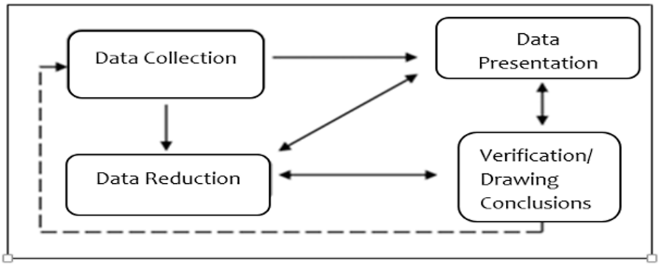

Fig. 2. Interactive analysis model.

A validity test will be conducted based on the conclusions obtained in this study. Creswell (2016: 269) explains that validity testing is conducted to verify the accuracy of research results through various procedures, one of which is triangulation. Researchers use various sources, theories, and methods to strengthen the data obtained. This study also gathers various perspectives from informants from officials, staff, and academics. Furthermore, the triangulation process is also carried out through ongoing interviews (flowing interviews), which are then followed by pattern matching to increase internal validity. Researchers also conduct member checking as part of the validity test.

4 Results and Discussion

4.1 Evaluation of income tax implementation for MSMEs in Indonesia

According to tax compliance theory, tax compliance is the behavior demonstrated by taxpayers in fulfilling their tax obligations in accordance with applicable regulations. In line with this theory, the research findings indicate that the implementation of MSME Income Tax in Indonesia, which has been in existence for more than 12 years, has not been optimally implemented and is not on target (has not resulted in improved compliance). The following are three key findings that indicate that MSME Income Tax has not been optimally implemented and is not on target.

MSME Income Tax Becomes a Loophole for Firm Splitting Practices. The results of the study show that the MSME Income Tax, which should be intended for MSME business entrepreneurs, is instead widely used by big businesses, which should not be able to use the MSME Income Tax. Big businesses use the MSME Income Tax to avoid taxes, namely through firm splitting. This method is carried out by dividing large companies into several small companies to benefit from the lower tax rates for small companies.

According to tax regulations, MSME entrepreneurs are individuals or business entities whose business turnover in a single tax year does not exceed IDR4.8 billion. In addition, MSME entrepreneurs can use MSME Income Tax if their business is in the form of trade. This means that if the type of business is in the form of independent professional and/or professional services, they are not entitled to use MSME Income Tax. For example, lawyers and tax consultants whose business turnover does not exceed

IDR4.8 billion in a fiscal year are not allowed to use the MSME Income Tax. Another requirement is that their income does not originate from outside the country.

The purpose of implementing MSME Income Tax is to provide convenience and improve tax compliance among MSME business entities. MSME Income Tax has a very low rate of only 0.5%. This is in contrast to the general rate, which is much higher. For individuals, the general rate is based on Income Tax Article 17, with rates ranging from 5% to 35% (progressive). Meanwhile, for business entities, the general rate is based on Corporate Income Tax, which is 22%. In addition, calculating MSME Income Tax is very simple, which is the business turnover in one month multiplied by a rate of 0.5%. PF 1 explains as follows.

"The low Income Tax rate for MSMEs is highly subject to abuse for tax avoidance, especially by large businesses. They deliberately split their business operations by creating new entities in order to obtain a lower tax rate" (Informant 1, Functional Official in the Policy Impact Subdirectorate).

PF 2 adds the following information.

"Many large businesses split their operations by continuously establishing new limited liability companies (PT) or other forms of legal entities when their business reaches nearly IDR4.8 billion." (Informant 2, Functional Official in the Taxpayer Compliance Risk and Data Science Subdirectorate).

Research shows that current tax regulations do not restrict individuals from establishing business entities. This allows individuals to own dozens or even hundreds of business entities. As a result, large entrepreneurs engage in firm splitting on a massive scale. One finding in the field shows that an entrepreneur and his core family, let's call him Mr. X, along with his wife and two children, own interrelated shares in more than 50 business entities. The types of businesses owned by one business entity and another are the same, namely trading in building materials or providing construction services. The amount of assets owned by Mr. X's family, as reported in the 20XX Annual Tax Return, is also fantastic, namely more than IDR249 billion. The following is an overview of the firm splitting carried out by Mr. X and his core family.

According to information from informants, the firm splitting method, as shown in Figure 3, is practiced by many other taxpayers. This can be seen from the increase in the number of taxpayers who are stuck at the IDR4.8 billion threshold throughout Indonesia (in order to continue benefiting from MSME Income Tax facilities). The following is detailed information.

The informants also added that the data in Table 1 is only data that is currently known to the DGT. The amount of data unknown to the DGT is certainly much greater, considering that the majority of businesses in Indonesia, namely 99.99%, are MSMEs and many are still not included in the DGT system.

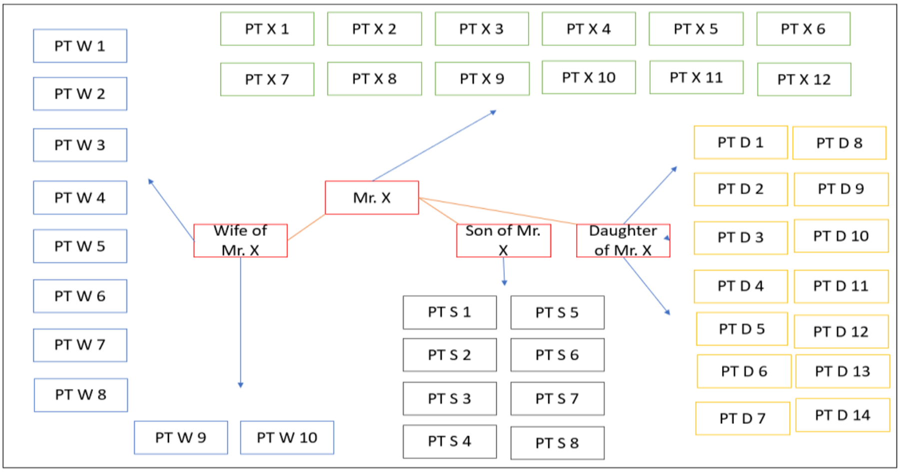

Fig. 3. Firm splitting scheme carried out by Mr. X's Family.
Source: Internal DGT data processed by the author.

Table 1. Comparison of the number of corporate taxpayers subject to the IDR4.8 billion threshold in 2022 and 2024.

Year	Amount	Percentage Compared to the Previous Year	Description
2022	5.725	0%	-
2024	17.440	305%	The percentage of taxpayers with business turnover of up to IDR 4.8 billion in 2024 is expected to increase by more than 300% compared to 2022

The threshold of IDR500 Million Becomes a Loophole for Taxpayers to Avoid Paying Taxes. A new provision in PP 55 concerns the turnover threshold for businesses that are required to pay MSME Income Tax. New MSME businesses are required to pay MSME Income Tax when their turnover exceeds IDR500 million. Meanwhile, MSME businesses with a turnover of up to IDR500 million are not required to pay MSME Income Tax. Prior to the enactment of PP 55, all MSME entrepreneurs were subject to tax, regardless of their business turnover. The following is an overview of the implementation of the threshold of up to IDR500 million.

In the case in Table 2, the business owner began making their MSME Income Tax payment in June 2025. The MSME Income Tax payable is IDR50,000.00 (IDR10,000,000.00 multiplied by 0.5%). In previous months, the business entity did not have an obligation to pay MSME Income Tax because its business turnover had not exceeded IDR500 million. PF 4 explains this as follows.

"The existence of an Income Tax threshold for MSMEs has resulted in an erosion of the tax base. Currently, we find it very difficult to monitor taxpayers whose business

turnover is less than IDR500 million. We do not have any comparative data." (Informant 4, Account Representative in the Regional Taxpayer Supervision Section).

Table 2. Illustration of the implementation of business turnover thresholds that are subject to MSME income tax.

Month	Year	Business Turnover (IDR)	Amount of Tax Payable (IDR)	Description
January	2025	100,000,000.00	0	No obligation to pay taxes
February	2025	150,000,000.00	0	No obligation to pay taxes
March	2025	100,000,000.00	0	No obligation to pay taxes
April	2025	100,000,000.00	0	No obligation to pay taxes
May	2025	50,000,000.00	0	No obligation to pay taxes
June	2025	10,000,000.00	50,000.00	Start paying Income Tax for MSMEs

PF 5 adds the following information.

"The implementation of the tax payment threshold for MSMEs, namely those with a business turnover of more than IDR500 million, is indeed applied more fairly because not all business turnover is subject to tax. However, in theory, with this threshold, the DGT has an increasingly heavy task in conducting supervision." (Informant 5, Taxation Lecturer at Yogyakarta State University).

The existence of a business turnover threshold of up to IDR500 million has resulted in many MSME entrepreneurs who previously paid taxes no longer doing so. One example of an Account Representative (Account Representative is a tax officer assigned to supervise the tax compliance of several taxpayers, who are spread across all vertical units of the DGT) who has experienced a significant decline in the number of MSME Income Tax payers is informant IV. Based on information from informant IV, the following is a comparison of the number of taxpayers managed by informant IV who paid MSME Income Tax from 2021 to 2025.

Based on Table 3, there was a decrease in the number of MSME taxpayers assisted by informant IV from 2021 to 2025. The decrease in the number of MSME taxpayers from 2021 to 2025 totaled more than 140 taxpayers. The informants added that the decline in paying MSME taxpayers was not only experienced by PF 4, but also by thousands of other Account Representatives. When totalled, there are thousands of taxpayers who previously paid MSME Income Tax, but currently do not pay MSME Income Tax.

The Period of Implementation of MSME Income Tax is Unfair to Individual MSME Entrepreneurs. Under current tax regulations, MSME taxpayers are divided into two categories, namely individual MSMEs and corporate MSMEs. There is a difference in the period of implementation of MSME Income Tax between these two categories. As shown in table 4, individual MSMEs are granted a longer period of use compared to corporate entities. This difference indicates a disparity in policy statement, which may lead to perceptions of unfairness among individual MSME entrepreneurs.

Table 3. Comparison of the number of MSME income tax payers assisted by informant IV from 2021 to 2025.

Year	Number of Registered MSME Taxpayers	Number of Taxpayers Paying Income Tax for MSMEs	Percentage	Description
2021	1.310	1.121	86%	Before the implementation of PP 55 (no payment threshold exceeding IDR500 million)
2022	1.401	1.002	72%	Since the implementation of PP 55, the number of registered taxpayers has increased, but the number of taxpayers has decreased.
2023	1.556	1.021	66%	Since the implementation of PP 55, the number of registered taxpayers has increased, but the number of taxpayers has decreased.
2024	1.601	989	62%	Since the implementation of PP 55, the number of registered taxpayers has increased, but the number of taxpayers has decreased.
2025	1.622	980	60%	Since the implementation of PP 55, the number of registered taxpayers has increased, but the number of taxpayers has decreased.

PF 1 explains as follows.

"Currently, the period of implementation of MSME Income Tax for Individuals is only 7 years. However, in reality, there are many MSME Individuals whose turnover does not exceed IDR4.8 billion, even though their businesses have been operating for more than 7 years. If the MSME Income Tax is discontinued and they have to switch to Income Tax at the general rate, this will be very burdensome for individual MSME businesses." (Informant 1, Functional Official in the Policy Impact Subdirectorate)

Business entities are operated by several people. Therefore, business entities can be categorized as having better resource capabilities than individuals. The 7-year period for the implementation of MSME Income Tax has caused difficulties for individual MSME entrepreneurs. Based on information from informants, there are still many individual MSME entrepreneurs whose businesses have been operating for more than 7 years, but whose business turnover has not exceeded IDR4.8 billion. The change from the MSME Income Tax mechanism to Income Tax Article 17 is not easy. MSME business owners must keep detailed records, calculate Income Tax Article 17 rigidly, and the tax rate is also very high, ranging from 5% to 35%. This policy can have an impact on tax costs that increasingly burden individual MSME taxpayers. In addition, this policy also has the potential to stifle individual MSME businesses.

Table 4. Table of income tax period for MSMEs.

Business Entities	Term of Use for MSME Income Tax	Description
Individual	7 Years	The maximum period of use is 7 years from the date of registration. After 7 years, even if the business turnover has not exceeded IDR4.8 billion, it must switch to using the Income Tax rate under Article 17
Business entities in the form of cooperatives, limited partnerships, firms, village-owned enterprises/village-owned enterprises	4 Years	The maximum period of use is 4 years from the date of registration. After 4 years, even if the business turnover has not exceeded IDR4.8 billion, it must switch to using the corporate Income Tax rate
Limited Liability Company	3 Years	The maximum period is 3 years from the date of registration. After 3 years, even if the business turnover is still below IDR4.8 billion, it must switch to using the corporate Income Tax rate

Following is an example of an individual MSME taxpayer who has encountered difficulties due to the MSME Income Tax period. Let us refer to him as Mr. Z. Mr. Z owns a family restaurant. The average annual turnover of his business from 2017 to 2024 is IDR2 billion. For 7 years, the MSME Income Tax payable for 1 year is IDR20,400,000.00 (IDR1,700,000.00 per month). Starting in 2025, Mr. Z must switch to using Income Tax Article 17, even though his business turnover has not exceeded IDR4.8 billion, because he has been using MSME Income Tax for more than 7 years. Due to this change, Mr. Z must pay a tax consultant to help with his tax reporting. The tax payable per year has also increased dramatically, to IDR51,000,000.00 (IDR4,250,000.00 per month). The following is the detailed calculation of Income Tax payable using Article 17 of the Income Tax Law:

Gross Income	IDR4,000,000,000.00
Net Income (10% of gross income)	IDR 400,000,000.00
(Non-Taxable Income)	
(1 wife with 3 children)	(IDR 72,000,000.00)
Taxable Income	**IDR 328,000,000.00**

Tax payable	IDR 60,000,000.00 x 5%	=IDR 3,000,000.00
	IDR190,000,000.00 x 15%	=IDR28,500,000.00
	IDR 78,000,000.00 x 25%	=IDR19,500,000.00
Total tax payable	**IDR328,000,000.00**	**=IDR51,000,000.00**

Mr. Z's tax payments increased by more than 100%. This situation put a heavy burden on Mr. Z's cash flow. According to information from informants, this situation is experienced by many other individual MSME taxpayers.

4.2 Proposed Improvements to the Implementation of MSME Income Tax in Indonesia

Based on the analysis that has been conducted and in accordance with tax compliance theory, tax compliance increases when the authorities act fairly and supportively, the researchers proposed three improvements so that the implementation of MSME Income Tax could be optimized and more targeted (fair and supportive), which can enhance MSME tax compliance. The following are the three proposed improvements to the implementation of MSME Income Tax, which will be explained in detail in the following subsections.

Proposal to limit the use of Income Tax for MSMEs for business entities. SMEs Income Tax is currently widely used as a means of tax avoidance, especially by large entrepreneurs through firm splitting. Current regulations do not restrict the use of SMEs Income Tax. An individual who owns dozens or even hundreds of business entities can use the SME Income Tax, as long as each business entity they own has a turnover not exceeding IDR4.8 billion (even though if all of their business entities are combined, their turnover is significantly above IDR4.8 billion). This situation allows large companies to easily split their business turnover so that they can continue to use the SME Income Tax. To address this issue, two alternatives have been proposed.

(i). Only one business entity can use the MSME Income Tax

The first alternative is to limit the use of MSME Income Tax for business entities. An entrepreneur and his core family are allowed to own multiple business entities, but only one business entity can use MSME Income Tax, while other business entities must use corporate Income Tax at a rate of 22%, even if each business entity owned has a turnover not exceeding IDR4.8 billion. PF 1 explains as follows.

"There needs to be a reassessment of restrictions on businesses owned by individuals and their families that can use the MSME Income Tax. This step is necessary to address the massive tax avoidance using the firm splitting method." (Informant 1, Functional Official in the Policy Impact Subdirectorate)

PF 5 adds the following explanation.

"In theory, large entrepreneurs have enormous capital, making it very easy to establish new business entities. Establishing a new business entity is cheaper than the

corporate Income Tax that must be paid every month. Therefore, it is necessary to restrict the use of MSME Income Tax for business entities." (Informant 5, Taxation Lecturer at Yogyakarta State University)

To further explain the restriction mechanism in which only one business entity can use the MSME Income Tax, the following is an illustration. Based on the illustration in Figure 4, only PT W1 can use the MSME Income Tax, while PT W2 to PT D2 must use the corporate Income Tax rate of 22%. This proposal is believed to be able to minimize firm splitting.

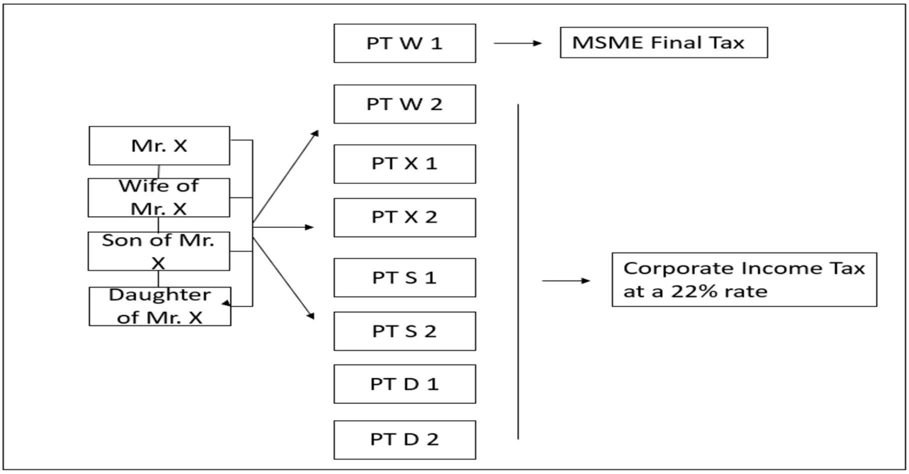

Fig. 4. Restriction that only one business entity owned by the same owner can use the MSME income tax.

(ii). Eliminate the business entity as the party entitled to use the MSME Income Tax

The second alternative is to eliminate business entities as parties eligible to use the MSME Income Tax. Based on the second alternative, the only parties eligible to use the MSME Income Tax are individual MSME taxpayers. PF 2 provides the following information.

"To reduce tax avoidance, particularly through firm splitting, business entities should be eliminated from the MSME criteria, so that they are required to pay corporate Income Tax at a rate of 22%." (Informant 2, Functional Official in the Taxpayer Compliance Risk and Data Science Subdirectorate)

PF 5 adds the following explanation.

"In theory, business entities can be excluded from receiving MSME facilities. This is also very effective in reducing firm splitting. (Informant 5, Taxation Lecturer at Yogyakarta State University)

The following is a further explanation of the mechanism for eliminating business entities as parties entitled to use MSME Income Tax. Based on the illustration in Figure 5, all business entities owned by Mr. X and his core family must use the corporate Income Tax rate, even though the turnover of each business entity has not exceeded IDR4.8 billion. This proposal can close the loophole of firm splitting because the potential for splitting business turnover has been largely eliminated.

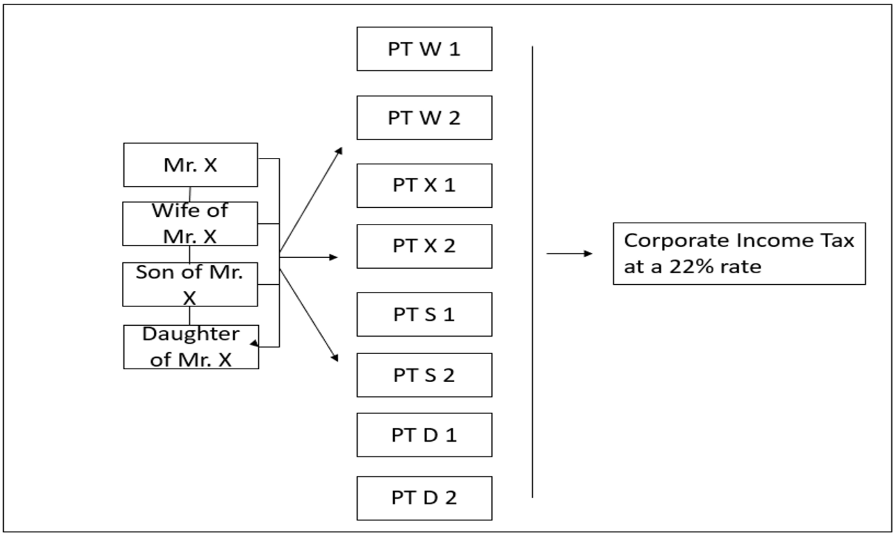

Fig. 5. Eliminating business entities as parties eligible to use the MSME income tax.

Proposal to make domestic e-commerce entities mandatory to submit transaction data to the DGT and assign domestic e-commerce entities as tax collectors. Based on the results of the study, the DGT requires comparative data to cross-check the accuracy of tax reports submitted by taxpayers, particularly in relation to the implementation of the threshold of up to IDR500 million. Informant 3 provided the following information.

"Currently, what is needed to conduct supervision is to increase comparative data, especially data from e-commerce, because currently many MSME businesses sell their products on e-commerce platforms rather than through traditional means." (Informant 3, Echelon IV Officials in the Regional Taxpayer Supervision Section at the Primary Tax Service Office)

Informant 4 added the following explanation.

"In my opinion, we can also assign domestic e-commerce as tax collectors. The mechanism is the same as for foreign e-commerce, which have already been assigned

as tax collectors. In addition to obtaining data, the DGT will also be assisted in collecting revenue." (Informant 4, Account Representative in the Regional Taxpayer Supervision Section)

Current sales trends are shifting significantly from traditional sales to digital sales. According to internal DGT data, more than 70% of sales are currently conducted digitally. With such a large number of digital product sales, one of the most important pieces of data needed to verify the accuracy of MSME taxpayer reports is sales and purchase transaction data from e-commerce. There are two ways that the DGT can obtain sales and purchase transaction data from e-commerce.

(i). Mandating all domestic e-commerce to provide data on sales and purchases made on e-commerce platforms

Sales and purchase data, such as sales invoices generated in e-commerce, contain very complete information, such as the seller's name; buyer's name; seller's address; buyer's address; number of items sold; and even the total sales price. This data is urgently needed by the DGT in monitoring the accuracy of tax reporting and payments by taxpayers, including MSME taxpayers. Therefore, the DGT needs to oblige all domestic e-commerce platforms to provide data on sales and purchase transactions occurring on e-commerce platforms to the DGT. The provision of this data can be done once a month. With hundreds or even millions of transaction data from e-commerce, it will greatly assist tax officials in cross-checking the accuracy of reporting and payments by MSME taxpayers. Thus, the tax potential of MSMEs can be optimized and tax evasion can be minimized.

(ii). Assigning domestic e-commerce as the collector of MSME Income Tax

According to current tax regulations, namely Minister of Finance Regulation No. 81 of 2024, e-commerce can be assigned as a tax collector. The designation of e-commerce as a tax collector has been in existence since 2020, but is currently limited to foreign e-commerce. Foreign e-commerce must collect Value Added Tax of 11% of the selling price when there is a purchase of intangible goods (e.g., software, applications, streaming movies, etc.) made by individuals or companies based on Indonesia from sellers located abroad through foreign e-commerce. The tax collected by foreign e-commerce will then be deposited into the Indonesian state treasury.

The following is an example of Value Added Tax collection by foreign e-commerce. An Indonesian citizen orders computer software sold by a seller in the United States, which is ordered through e-commerce based in China. The e-commerce based in China has been assigned by the DGT as a tax collector. For the purchase of intangible goods in the form of computer software, the e-commerce company based in China will collect Value Added Tax and provide a Value Added Tax collection receipt to the seller located overseas. The Value Added Tax collected by the e-commerce company will then be deposited into the Indonesian state treasury.

According to the results of the analysis that has been carried out, the assignment of e-commerce as a tax collector can be expanded, not only for foreign e-commerce, but also for domestic e-commerce (current regulations are very accommodating). The following is a proposal for the assignment of domestic e-commerce as a collector of MSME Income Tax.

Based on Fig. 6, e-commerce is a platform for domestic sales and purchase transactions between sellers and buyers. When buyers purchase goods from sellers through e-commerce, e-commerce will receive payment from buyers. Before transferring the money to sellers, e-commerce will collect MSME Income Tax. After the MSME income tax is collected, the money will be transferred to the seller along with the MSME Income Tax deduction slip. This deduction slip is used as evidence that the seller has paid the MSME Income Tax, so there is no need to pay tax again on the same transaction. With the mechanism of assigning e-commerce as the collector of MSME Income Tax, hundreds of thousands or even millions of sales transactions are automatically deposited into the state treasury every day.

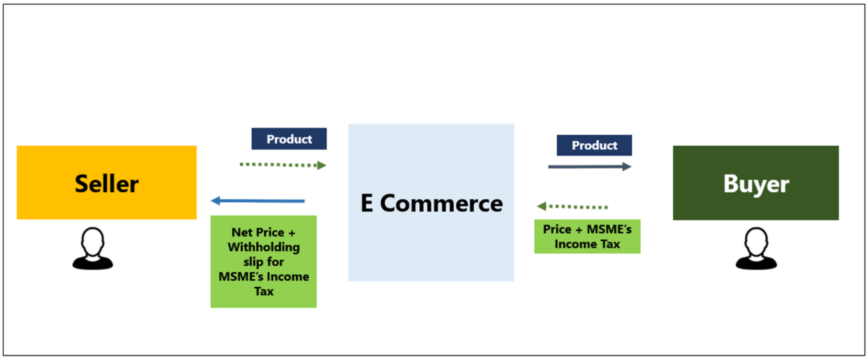

Fig. 6. Mechanism for collecting MSME income tax by domestic e-commerce.

Proposal to allow lifetime use of MSME Income Tax for individual MSMEs. According to current tax regulations, the use of MSME Income Tax for individual MSME taxpayers can only be used for 7 years. Individual MSME business owners are forced to switch to Article 17 Income Tax after 7 years of using MSME Income Tax, even though their business turnover has not exceeded IDR4.8 billion. Informants report that there are many cases in the field where individual MSME taxpayers have been registered for more than 7 years, but their business turnover has not exceeded IDR4.8 billion. Many individual taxpayers have complained to informants about this regulation.

Informants also added that MSME business owners whose business turnover does not exceed IDR4.8 billion do not have sufficient resources to implement Income Tax Article 17. Income Tax Article 17 has a complicated calculation method; high progressive tax rates (5% to 35%); and requires the readiness to use information technology. The change in the application of this regulation is very burdensome for individual MSME taxpayers whose business turnover has not exceeded IDR 4.8 billion. Income Tax Article 17 is more appropriate for individual taxpayers who are classified as large businesses (with a business turnover exceeding IDR4.8 billion), as they already have the resources to implement Income Tax Article 17.

Therefore, it is proposed that the use of MSME Income Tax for individuals be applied for a lifetime. Under this mechanism, individual MSME taxpayers are required to use Income Tax Article 17 after their business turnover for one year has exceeded IDR4.8 billion. When business turnover exceeds IDR4.8 billion, individual MSME taxpayers already have the ability to implement Income Tax Article 17, so that changes in the use of regulations do not disrupt business. In the case where an individual MSME taxpayer's business turnover has reached IDR4.8 billion, but in subsequent years their business turnover falls back below IDR4.8 billion, the individual MSME taxpayer can no longer use the MSME Income Tax (because tax regulations must be applied consistently). With this mechanism, the change from the MSME Income Tax to Income Tax Article 17 occurs because the individual taxpayer is indeed able to use these regulations (financially capable because their business turnover is above IDR4.8 billion in one tax year).

4.3 Potential Additional Income Tax Revenue and Increase in the Number of Taxable Entrepreneurs from the Implementation of Proposed Improvements

Based on the analysis that has been conducted, it shows that by eliminating business entities as parties that can use the MSME Income Tax facility; making e-commerce parties obliged to submit transaction data and making domestic e-commerce as tax collectors, it can increase tax revenue and be more targeted (MSME Income Tax will actually be used by MSME entrepreneurs, not by large entrepreneurs).

Table 5. Table of minimum income tax potential obtained from the implementation of proposed improvements.

Total Taxpayers Held Back at IDR4.8 Billion	Estimated Minimum Business Turnover in One Year (IDR)	Using the assumption of average net income of trading companies (10%) (IDR)	Corporate Income Tax Rate (%)	Amount of Income Tax Payable by each Business Entity (IDR)	Total potential corporate Income Tax (IDR)
17,440 Note: Amount in 2024	4,800,000,001.00	480,000,000.00 Note: Under current tax regulations, the standard estimate for trading companies is 10% of their total revenue	22	105,600,000.00	**1,841,664,000,000.00** Note: The calculation is obtained from 17,440 multiplied by IDR105,600,000.00

Source: Internal DGT data processed by the author

The following is the potential minimum Income Tax obtained from the implementation of the proposed improvements. Based on Table 5, there is a potential for additional revenue from the implementation of the proposed improvements amounting to IDR1,841,664,000,000.00. The potential tax amount in Table 5 is the minimum additional Income Tax potential, as it uses the minimum business turnover of IDR4,800,000,001.00. In addition, it only uses data on taxpayers whose business turnover is held at up to IDR4,800,000,001.00 by the end of 2024 (there is a possibility that the actual amount is much higher but has not yet been recorded in the DGT system).

In addition to potential Income Tax revenue, the implementation of the proposed improvements also has the potential to increase the number of Taxable Entrepreneurs. Taxable Entrepreneurs are entrepreneurs whose business turnover in one tax year exceeds IDR4,800,000,001.00, so they are required to issue Tax Invoices and collect Value Added Tax on every transaction. The following is the potential minimum number of additional Taxable Entrepreneurs resulting from the implementation of the proposed improvements.

Based on Table 6, there is a potential for at least 17,440 new taxable entrepreneurs as a result of the proposed improvements. This finding is consistent with previous studies indicating that policy simplification and tax incentives can significantly increase taxpayer compliance and participation [23]. Furthermore, the addition of taxable entrepreneur is expected to contribute to an increase in Value Added Tax (VAT) revenue, as broader tax bases are generally associated with higher indirect tax collection [24].

Table 6. Table potential number of additional taxable entrepreneurs obtained from the implementation of the proposed improvements.

Total Taxpayers Held Back at IDR4.8 Billion	**Minimum Number of New Taxable Entrepreneurs**	**Description**
17,440	17,440	The amount of capital held in circulation will reach IDR4.8 billion in 2024

Source: Internal DGT data processed by the author.

5 Conclusion and Recommendation

Based on the results of research that has been conducted, it shows that the implementation of MSME Income Tax has not been carried out optimally. In fact, MSME Income Tax has not been on target, so it is not in line with the objectives of implementing MSME Income Tax. There are three main reasons why the implementation of MSME Income Tax has not been optimally applied and has not been on target. First, MSME Income Tax is widely used by large entrepreneurs to avoid taxes through firm splitting. Second, the business turnover threshold of up to IDR500 million (not subject to tax) is a major loophole used by non-compliant entrepreneurs to avoid paying taxes (not paying taxes at all). Third, the 7-year period for the use of MSME Income Tax for individual MSME entrepreneurs makes it difficult for individual MSME entrepreneurs to run their businesses (considered unfair because it does not reflect the actual situation).

In order to address all the issues identified in the study, there are three proposed improvements that can optimize the implementation of MSME Income Tax and make it more targeted. First, to minimize firm splitting, it is proposed to create a new mechanism related to the use of MSME Income Tax for business entities, namely limiting only one business entity owned by the same person to be allowed to use MSME Income Tax; or removing business entities as parties that can use MSME Income Tax. Second, to improve the provision of comparative data by requiring e-commerce platforms to provide transaction data to the DGT; and assigning e-commerce platforms as collectors of MSME Income Tax. Third, to provide convenience and fairness for MSME entrepreneurs, especially for individual MSME entrepreneurs, it is proposed that MSME Income Tax be applicable for a lifetime. In addition, there is a potential increase in minimum Income Tax of IDR1,841,664,000,000.00 from the implementation of the proposed improvements. Furthermore, there is a potential for an additional 17,440 new Taxable Entrepreneurs. The increase in Taxable Entrepreneurs will also have an impact on the increase in Value Added Tax payments.

Based on the research results, there are several theoretical and practical implications. First, the findings can support the development of tax compliance theory. The results of this study support tax compliance theory by demonstrating that tax compliance can increase when policies are implemented in a fair and supportive manner. Furthermore, the findings add that compliance can also improve when supervision is conducted fairly and based on accurate data. Second, tax avoidance through firm splitting has occurred very massively due to the absence of restrictions on the use of MSME Income Tax for business entities. Therefore, the DGT should immediately revise the tax regulation (Government Regulation No. 55), particularly by imposing restrictions on the use of MSME Income Tax for business entities or even stipulating that business entities are not eligible subjects to use the MSME Income Tax scheme. Third, currently many taxpayers who previously paid MSME Income Tax no longer pay taxes on the grounds that their business turnover has not exceeded IDR500 million. The DGT requires third-party or comparison data to verify the accuracy of taxpayers' reporting. Therefore, the DGT should promptly issue a new regulation requiring e-commerce platforms to provide transaction data to the DGT and/or assign e-commerce platforms as tax withholding agents. Fourth, the time limitation on the use of MSME Income Tax for individual MSME taxpayers creates a significant burden. Therefore, in order to ensure fairness, the DGT should revise the regulation concerning the time limitation on the use of MSME Income Tax for individual MSME taxpayers, allowing it to be used for a lifetime.

The researchers acknowledge that this study still has many limitations. Informants in this study were limited to the DGT and academics. For further research, it would be advisable to also include informants from taxpayers, in order to gain a better understanding of their perspective. Secondly, observations were only conducted at the Directorate of Potential, Compliance, and Revenue. For future research, observations could also be conducted in the field (where taxpayers are located), in order to obtain more in-depth information.

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