Indonesian Tax Justice Review
ISSN: XXXX-XXXXX (Online)
Vol. 3, No. 1, 2026, pp. 17-34
Published online since February 13, 2026

Tax Justice for Indonesian Micro and Small Enterprises: Evaluating the Fairness of Final Income Tax Regimes for UMKM

Rindia Putri*
Universitas Brawijaya, Malang, Indonesia
ririnputri@gmail.com

DOI: https://doi.org/10.65815/07zwg424

Submitted: 22-08-2025	Revised: 27-11-2025; 05-01-2026	Accepted: 03-02-2026

*Corresponding Author

Abstract

Micro, small, and medium enterprises (UMKM) constitute a significant component of Indonesia's economy and provide livelihoods for millions of individuals. Simplified final income tax regimes have been introduced to reduce administrative burdens and improve voluntary compliance among small businesses. However, the application of turnover-based taxation may produce different effects depending on profit margins, business sectors, and economic conditions. This article examines the fairness of Indonesia's final income tax regime for UMKM. Using normative juridical research and tax policy analysis, the study evaluates the relationship between tax simplicity, ability-to-pay principles, administrative costs, and distributive justice. The article argues that a uniform turnover-based approach may disproportionately burden businesses operating with low profit margins while potentially providing advantages to businesses with higher margins. The study proposes a more differentiated tax justice framework incorporating taxpayer capacity, sectoral characteristics, simplified record-keeping, and targeted relief for vulnerable micro-enterprises. Tax administration should also provide accessible assistance rather than relying primarily on enforcement mechanisms. The article concludes that effective UMKM taxation requires a balance between simplicity and equity. A justice-oriented tax regime should facilitate formalization and compliance without imposing disproportionate fiscal burdens on entrepreneurs with limited economic capacity.

[*Usaha Mikro, Kecil, dan Menengah (UMKM) merupakan komponen penting perekonomian Indonesia dan menyediakan mata pencaharian bagi jutaan orang. Rezim pajak penghasilan final yang disederhanakan telah diperkenalkan untuk mengurangi beban administrasi dan meningkatkan kepatuhan sukarela di kalangan usaha kecil. Namun, penerapan pajak berbasis omset dapat menghasilkan efek yang berbeda tergantung pada margin keuntungan, sektor usaha, dan kondisi ekonomi. Artikel ini mengkaji keadilan rezim pajak penghasilan final Indonesia untuk UMKM. Dengan menggunakan penelitian yuridis normatif dan analisis kebijakan pajak, studi* *ini mengevaluasi hubungan antara kesederhanaan pajak, prinsip kemampuan membayar, biaya administrasi, dan keadilan distributif. Artikel ini berpendapat bahwa pendekatan berbasis omset yang seragam dapat secara tidak proporsional membebani usaha yang beroperasi dengan margin keuntungan rendah, sementara berpotensi memberikan keuntungan kepada usaha dengan margin yang lebih tinggi. Studi ini mengusulkan kerangka keadilan pajak yang lebih terdiferensiasi yang menggabungkan kapasitas wajib pajak, karakteristik sektoral, pencatatan yang disederhanakan, dan bantuan yang ditargetkan untuk usaha mikro yang rentan. Administrasi pajak juga harus menyediakan bantuan yang mudah diakses daripada hanya mengandalkan mekanisme penegakan hukum. Artikel ini menyimpulkan bahwa perpajakan UMKM yang efektif membutuhkan keseimbangan antara kesederhanaan dan keadilan. Rezim pajak yang berorientasi pada keadilan harus memfasilitasi formalisasi dan kepatuhan tanpa membebankan beban fiskal yang tidak proporsional kepada para pengusaha dengan kapasitas ekonomi terbatas.*]

Keywords: UMKM, small business taxation, final income tax, ability to pay, tax justice

Introduction

Micro, small, and medium enterprises occupy a structurally important position in Indonesia's economy. Government data reported before 2026 indicate that UMKM account for approximately 99 percent of business units, contribute around 60 percent of national GDP, and absorb close to 97 percent of employment. Their importance therefore extends beyond conventional measures of production because UMKM also function as mechanisms of livelihood creation, income distribution, and economic resilience. In many communities, particularly outside major urban centres, micro-enterprises operate not merely as profit-maximising firms but as household-based economic activities whose revenues support basic consumption and employment. This socioeconomic characteristic makes taxation of UMKM fundamentally different from taxation of large corporations. A tax regime that appears administratively efficient at the aggregate level may nevertheless become distributively problematic if it ignores differences in profitability and economic vulnerability. Tax justice in this context must therefore consider both the state's interest in broadening the tax base and the taxpayer's capacity to bear the resulting fiscal burden.

Indonesia has responded to the administrative difficulties of taxing small businesses through presumptive and simplified taxation. The current framework established by Government Regulation No. 55 of 2022 provides a final income tax mechanism for taxpayers with certain gross turnover, generally applying a rate of 0.5 percent to eligible business turnover. For individual taxpayers, the framework also provides that the first IDR 500 million of annual gross turnover is not subject to final income tax, while the simplified regime is available within the prescribed turnover ceiling and taxpayer eligibility requirements (Government of Indonesia 2022). The policy represents a substantial reduction in administrative complexity compared with a conventional income tax system requiring detailed calculation of deductible expenses, depreciation, inventory, and net taxable income. Its underlying rationale is therefore understandable: when taxpayers have limited bookkeeping capacity and the tax authority faces high monitoring costs, turnover provides an observable and administratively inexpensive proxy for taxable capacity.

The central difficulty is that turnover is not income. A business with IDR 1 billion in annual sales may generate a high net margin, while another business with the same turnover may operate on a very narrow margin because of high input costs, labour expenses, transportation costs, rent, spoilage, or inventory requirements. Under a final tax imposed on gross turnover, both businesses may face the same nominal tax liability even though their actual economic capacities are materially different. This problem creates a direct tension between administrative simplicity and the ability-to-pay principle. The issue was already identified in international tax-policy analysis of Indonesia: the International Monetary Fund observed that turnover-based SME taxation can generate horizontal inequities between businesses with different margins and may create incentives against business expansion or encourage fragmentation into smaller entities (IMF 2019). The concern is therefore not theoretical. A tax base that is easy to observe may simultaneously be an imperfect measure of the taxpayer's capacity to contribute.

The reduction of the final tax rate from 1 percent under the earlier regime to 0.5 percent under Government Regulation No. 23 of 2018 and its continuation under Government Regulation No. 55 of 2022 substantially improved the proportional burden for many small taxpayers. Empirical research in Indonesia has found that lower rates can improve taxpayer preferences toward compliance, while tax knowledge, perceptions of fairness, audit probability, and trust also influence compliance behaviour (Wulan and Kresnawati 2019; Inasius 2015). This indicates that a lower rate is not merely a revenue sacrifice but can function as a compliance instrument. Nevertheless, the normative question remains whether a low rate automatically makes the system fair. A 0.5 percent tax can be very small relative to the turnover of a highly profitable business while being significant for a low-margin or loss-making business. The appropriate evaluation must therefore move beyond the statutory rate and examine the relationship between the tax base, economic capacity, profitability, and taxpayer vulnerability.

The problem becomes more significant when the policy is viewed through horizontal equity. Taxpayers who are economically similar should generally bear comparable tax burdens, while taxpayers who possess materially different economic capacities may legitimately receive different treatment. Musgrave argues that horizontal equity has independent normative importance and should not simply be treated as a derivative of vertical equity (Musgrave 1990). A turnover-based regime can violate this principle when businesses with identical turnover but substantially different margins are taxed identically. Conversely, a highly individualised net-income system may impose compliance costs that are themselves inequitable because micro-enterprises lack the accounting capacity of larger firms. Tax justice therefore requires a balance. The challenge is not to eliminate presumptive taxation altogether but to design it so that administrative simplification does not systematically override differences in economic capacity. The fairness of the regime should consequently be evaluated by asking whether the simplification mechanism remains a reasonable proxy for ability to pay across the population of businesses to which it applies. RCNi Company Limited

This article argues that Indonesia's final income tax regime for UMKM is administratively rational but distributively incomplete. The 0.5 percent turnover-based approach can legitimately reduce compliance costs, encourage formalisation, and expand the tax base, particularly for micro-enterprises that cannot maintain sophisticated accounting records. However, uniform application of the same turnover-based burden to businesses with substantially different margins undermines ability-to-pay and horizontal equity. The appropriate reform is therefore not the immediate replacement of the simplified regime with full net-income taxation. Such a reform could recreate the compliance barriers that the simplified regime was designed to remove. Instead, Indonesia should develop a differentiated justice-oriented framework in which simplicity remains the default, but the tax system recognises sectoral profitability, taxpayer capacity, vulnerability, and business maturity. Such differentiation would preserve the benefits of presumptive taxation while reducing its most serious distributive distortions.

Literature Review and Research Gap

The theoretical literature on tax justice establishes that taxation cannot be evaluated exclusively through the efficiency of revenue collection. Rawls's theory of justice places fairness within a broader institutional structure in which social and economic arrangements must be assessed according to their effects on individuals who occupy different positions within society (Rawls 1971). Murphy and Nagel similarly argue that taxation cannot be evaluated simply by asking how much property taxpayers surrender because the legal and economic institutions that define ownership and income are themselves constructed through public institutions (Murphy and Nagel 2002). These perspectives are relevant to UMKM taxation because small businesses operate within an institutional environment supported by public infrastructure, legal enforcement, markets, education, and government services. Nevertheless, justice also requires recognition of differences in vulnerability and economic capacity. A tax system that treats a subsistence-oriented micro-enterprise identically to a highly profitable small business merely because both report the same turnover may satisfy formal uniformity while failing the deeper requirement of distributive fairness.

Ability to pay provides a more specific framework for analysing the relationship between tax liability and economic capacity. In conventional income taxation, net income is generally regarded as a closer approximation of taxable capacity because it considers the resources remaining after costs associated with generating income. Turnover taxation instead assumes that gross sales provide sufficient information to estimate capacity without requiring detailed verification of expenses. Presumptive taxation is therefore fundamentally a compromise between theoretical precision and administrative feasibility. Casanegra de Jantscher and Tanzi explain that presumptive taxation emerged primarily from administrative considerations, particularly where conventional assessment of actual income is difficult or costly (Casanegra de Jantscher and Tanzi 1987). The normative problem arises when the administrative proxy becomes too distant from the economic reality it is intended to measure. A presumptive tax is legitimate only so long as the proxy remains reasonably correlated with taxable capacity. When profit margins vary substantially across sectors, the relationship between turnover and capacity weakens, increasing the risk of unequal taxation.

The contemporary literature on presumptive taxation recognises precisely this tension. The OECD explains that simplified regimes are designed to reduce compliance and administrative costs for micro and small businesses and can support formalisation when actual taxable income is difficult to determine (OECD 2023). However, the OECD also emphasises the importance of appropriate eligibility rules, thresholds, rates, and safeguards because simplified regimes can generate distortions or opportunities for abuse when poorly designed (OECD 2023; OECD 2024). Similarly, the IMF identifies turnover taxes as useful instruments for reducing compliance costs but stresses that their design must account for profitability, the threshold separating simplified and standard regimes, and incentives for firms to remain artificially small (Wen 2023; Wei and Wen 2023). These findings provide an important analytical foundation for Indonesia: simplicity is not itself evidence of fairness. The fairness of a presumptive regime depends on whether its administrative advantages outweigh the distributive distortions generated by using turnover as a tax base.

International evidence also shows that small businesses face disproportionately high compliance costs. Coolidge's research for the World Bank demonstrates that compliance costs can impose a particularly heavy burden on small firms because many tax administration requirements involve fixed costs that do not decline proportionately with business size (Coolidge 2010). Subsequent World Bank evidence similarly indicates that complex bookkeeping, multiple filings, and administrative interactions can impose substantial burdens on small businesses, sometimes creating incentives to remain informal rather than enter the formal tax system. This evidence strengthens the case for simplified taxation. Yet it simultaneously suggests that administrative simplicity should be understood as part of tax justice rather than merely as a convenience. A small taxpayer may experience an apparently modest tax liability as disproportionately burdensome when the time, professional assistance, digital access, and documentation required to comply are taken into account. Fair taxation therefore requires attention to both the fiscal burden and the cost of complying with the fiscal obligation.

The Indonesian empirical literature provides additional evidence concerning the relationship between tax design and compliance. Inasius's study of Indonesian SME retailers found that tax rates were negatively associated with compliance, while tax knowledge, audit probability, and social influences were positively associated with compliance (Inasius 2015). Wulan and Kresnawati found experimentally that reducing the rate and simplifying the calculation method under Government Regulation No. 23 of 2018 increased taxpayer preferences toward compliance (Wulan and Kresnawati 2019). Research by Yudha and Dewi similarly found that taxpayer knowledge and socialisation were important in compliance after the implementation of the 0.5 percent regime (Yudha and Dewi 2020). These studies demonstrate that compliance is influenced by more than the statutory rate. The design of the tax base, accessibility of information, perceived fairness, and administrative simplicity collectively shape taxpayer behaviour.

Research concerning tax morale reinforces the argument that fairness is an institutional variable rather than simply a taxpayer attitude. Timothy and Abbas found among Indonesian SMEs that tax compliance was positively associated with tax morale, perceptions of justice, trust in public authorities, and tax knowledge, with tax morale demonstrating particularly strong relevance (Timothy and Abbas 2021). Inasius similarly found that perceptions of equity and fairness influence SME tax compliance (Inasius 2019). This literature suggests that a tax regime can be administratively simple but still undermine compliance if taxpayers perceive the underlying allocation of burdens as unjust. The implication is particularly important for turnover-based taxation because the taxpayer may understand the simplicity of the calculation while simultaneously believing that the tax fails to reflect the profitability of the business. Perceived injustice can therefore undermine the behavioural benefits that simplification is intended to create. Tax administration should consequently regard fairness not as a secondary communication issue but as a substantive component of compliance policy.

The literature on Indonesian UMKM taxation nevertheless leaves an important research gap. Existing studies frequently examine whether the 0.5 percent regime improves compliance, reduces administrative burdens, or constitutes a legal facility for small taxpayers. Other studies identify concerns about fairness and ability to pay, particularly because final taxation applies to turnover rather than net profit. What remains insufficiently developed is an integrated normative framework that evaluates the regime simultaneously through administrative simplicity, ability to pay, horizontal equity, compliance costs, and taxpayer vulnerability. This article addresses that gap by treating these considerations as interconnected rather than competing policy objectives. It argues that the central question is not whether turnover taxation is inherently fair or unfair, but under what institutional conditions turnover can function as a legitimate proxy for taxable capacity. This approach allows the analysis to move from a binary debate about retaining or abolishing final taxation toward a more differentiated model of tax justice.

Method

This study uses a normative juridical method combined with descriptive, argumentative, and analytical tax-policy analysis. The normative juridical approach is employed because the principal object of the research is the legal design of Indonesia's final income tax regime for taxpayers with certain gross turnover, particularly the framework established through Government Regulation No. 55 of 2022. The study examines the legal basis, taxpayer eligibility, turnover threshold, final tax rate, exemption for the first IDR 500 million of annual turnover for eligible individual taxpayers, duration of access to the regime, and transition toward the ordinary income tax system. These provisions are then assessed against normative principles derived from the literature on tax justice and presumptive taxation. The analysis therefore does not seek to estimate the statistical impact of the regime on aggregate tax revenue. Instead, it evaluates whether the structure of the regime can be justified as a fair allocation of tax burdens among taxpayers with different economic circumstances.

The primary legal materials consist of the Income Tax Law as amended, the Harmonisation of Tax Regulations Law, Government Regulation No. 23 of 2018, and Government Regulation No. 55 of 2022. Government Regulation No. 23 of 2018 is examined primarily as the historical foundation of the 0.5 percent regime, whereas Government Regulation No. 55 of 2022 constitutes the principal regulatory framework analysed in this article. The study also considers Government Regulation No. 7 of 2021 concerning the facilitation, protection, and empowerment of cooperatives and UMKM because taxation cannot be separated from the broader legal policy governing small-business development. The regulatory analysis is intentionally limited to the legal position and scholarly materials available through December 2025. This temporal limitation is important because it prevents subsequent regulatory developments from retroactively influencing the normative assessment of the regime examined in the article.

The secondary materials comprise international tax-policy reports, peer-reviewed academic literature, Indonesian empirical studies, and theoretical works on distributive justice and taxpayer behaviour. The OECD and IMF literature provides the principal comparative framework for evaluating presumptive taxation, while the World Bank literature establishes the importance of compliance costs for small businesses. Musgrave, Rawls, and Murphy and Nagel provide the normative foundations for horizontal equity, fairness, and distributive justice. Indonesian empirical studies are used to contextualise the relationship between rate reductions, taxpayer knowledge, perceptions of fairness, tax morale, and compliance. This combination is important because a purely doctrinal analysis could establish whether the regime is legally valid without adequately evaluating its distributive consequences. Conversely, a purely empirical approach could identify compliance outcomes without answering the normative question of whether identical turnover should produce identical tax burdens when businesses possess materially different profit margins.

The analytical framework consists of four principal dimensions. The first is ability to pay, which asks whether the tax burden corresponds reasonably to the taxpayer's economic capacity. The second is horizontal equity, which examines whether economically comparable taxpayers receive comparable treatment and whether differences in tax burdens are justified by relevant economic differences. The third is administrative proportionality, which evaluates whether the simplicity gained from turnover taxation justifies the distributive costs created by using turnover as a proxy for income. The fourth is compliance and formalisation, which considers whether the regime encourages taxpayers to enter and remain within the formal economy. These dimensions are analysed together because maximising one dimension may undermine another. A highly precise profit-based regime may better reflect ability to pay but create excessive compliance costs, while a highly simplified turnover regime may reduce compliance costs but generate inequities. Tax justice therefore requires a defensible equilibrium rather than the unconditional prioritisation of either simplicity or precision.

Analysis and Discussion

A. The Legal and Policy Rationale of Final Income Tax for UMKM

The legal rationale of Indonesia's final income tax regime for UMKM rests primarily on simplification, certainty, and accessibility. Government Regulation No. 55 of 2022 explicitly identifies legal certainty, simplification of tax administration, convenience, and fairness as policy considerations underlying the regulation. This is significant because the simplified regime is not legally framed merely as a revenue-raising instrument. It represents a deliberate recognition that taxpayers with relatively limited turnover may face disproportionate difficulties under the ordinary income tax system. By calculating tax from gross turnover, the government avoids requiring every micro-enterprise to maintain detailed profit-and-loss accounts and document every deductible expense. From an administrative perspective, this can reduce both taxpayer compliance costs and the tax authority's verification costs. The legal legitimacy of the regime is therefore strongly connected to the principle of administrative proportionality: the state may legitimately use a simplified proxy where the cost of measuring actual income would exceed the additional fairness obtained from more precise assessment.

The 0.5 percent rate must also be understood as part of a broader transition from the earlier 1 percent turnover regime. The reduction under Government Regulation No. 23 of 2018 was intended to make taxation less burdensome and encourage formal participation. Empirical research provides support for this policy rationale. Wulan and Kresnawati found that reducing the rate and changing the calculation mechanism influenced taxpayers' compliance preferences positively, while Inasius found that tax rates were negatively associated with SME compliance

(Wulan and Kresnawati 2019; Inasius 2015). The importance of this evidence is that the effectiveness of a tax regime cannot be assessed exclusively through its nominal revenue yield. A tax that is theoretically more accurate but practically too complex or costly may produce lower actual compliance than a simplified regime. The 0.5 percent approach therefore possesses a legitimate efficiency and compliance justification, particularly for taxpayers operating at the smallest scale and without sophisticated accounting capabilities.

The exemption of the first IDR 500 million of annual turnover for eligible individual taxpayers further strengthens the social-justice rationale of the current framework. The exemption recognises that gross receipts at the very lowest levels should not automatically generate an income tax liability, particularly when the enterprise may function primarily as a livelihood activity. This mechanism moves the regime somewhat closer to ability-to-pay principles because it prevents the smallest individual businesses from being taxed from the first rupiah of turnover. However, the exemption does not fully resolve the underlying problem because turnover above the threshold remains the tax base rather than net income. A micro-enterprise with IDR 600 million in turnover and a very low margin may still have a weaker ability to pay than a business with the same turnover and a substantially higher margin. The exemption is therefore best understood as a partial correction to the regressivity of turnover taxation rather than a complete solution to the ability-to-pay problem.

The temporary availability of the simplified regime also reflects a policy assumption that businesses should eventually graduate toward ordinary taxation as their administrative capacity develops. Government Regulation No. 55 of 2022 provides different maximum periods depending on the legal form of the taxpayer, including longer access for individual taxpayers and shorter periods for certain corporate entities. This structure suggests that the simplified regime is conceptually intended to support the early stages of business formalisation rather than permanently replace the ordinary income tax system. Such a design is consistent with international policy guidance, which warns that simplified regimes can create incentives for businesses to remain artificially small if the tax advantage is too generous or permanent (OECD 2015; Wei and Wen 2019). However, graduation must be realistic. If taxpayers are required to transition into a substantially more complex system before they possess the accounting and administrative capacity to comply, the result may be renewed informality rather than genuine business maturation.

B. Turnover Taxation and the Ability-to-Pay Principle

The principal weakness of final turnover taxation is its imperfect relationship with ability to pay. Ability to pay requires taxation to reflect differences in economic capacity, yet turnover measures the scale of transactions rather than the income retained by the business owner. Consider two retailers, each generating IDR 2 billion in annual sales. The first operates with a 25 percent net margin and therefore generates substantially more economic income than the second, which operates with a 3 percent margin. A 0.5 percent turnover tax produces the same nominal liability for both taxpayers, even though the tax represents a much larger proportion of the second taxpayer's economic income. The problem becomes even more serious when the business experiences temporary losses. A turnover-based final tax may remain payable despite the absence of net profit. The tax consequently becomes disconnected from the economic resource that income taxation ordinarily seeks to measure. This is the central distributive weakness of a uniform turnover-based regime.

The problem has been explicitly identified in the international literature. The IMF's analysis of Indonesia concluded that the country's previous SME turnover regime generated horizontal inequities because businesses with different profit margins could face identical tax burdens despite possessing different economic capacities (IMF 2019). More recent IMF research similarly demonstrates theoretically that proportional turnover taxation generates horizontal inequity unless firms have identical profit margins (Wei and Wen 2023). This finding has direct implications for Indonesia because the economy contains highly diverse business models. Retail, food services, manufacturing, agriculture, professional services, transportation, and digital businesses can exhibit radically different relationships between gross turnover and net income. A single turnover rate therefore embeds an assumption of broadly similar profitability that is difficult to defend empirically. The lower the rate, the smaller the distortion may be in absolute terms, but the underlying inequity remains structurally present.

The ability-to-pay problem does not mean that all presumptive taxation is unjust. A presumptive tax can be justified when the chosen proxy is sufficiently correlated with economic capacity and when the administrative savings are substantial. The question is therefore one of proportionality. If the difference between turnover and income is relatively predictable within a particular sector, turnover may function as a reasonable approximation. If margins fluctuate dramatically, the same proxy becomes much less defensible. This suggests that the Indonesian regime should not necessarily abandon turnover taxation but should improve its capacity to account for systematic differences in profitability. Sector-sensitive presumptive rates, simplified expense deductions, or optional simplified net-income methods could narrow the gap between administrative simplicity and ability to pay. Such mechanisms would preserve the principal advantage of presumptive taxation while acknowledging that economic capacity cannot always be inferred from sales volume alone.

A differentiated approach would also improve the conceptual consistency of the tax system. Taxpayers often understand fairness comparatively: they evaluate whether their own burden appears reasonable relative to businesses operating in similar circumstances. If a low-margin business pays a similar effective tax burden to a high-margin competitor, the former may perceive the system as unfair even if the statutory rate is objectively low. Research on Indonesian SMEs supports this behavioural dimension. Timothy and Abbas found that perceptions of justice, trust, tax morale, and tax knowledge are positively associated with compliance (Timothy and Abbas 2021). Thus, the ability-to-pay problem is not merely a philosophical concern. Perceived disconnection between tax liability and economic capacity may undermine voluntary compliance, especially when taxpayers observe other businesses with similar turnover but very different profitability. Tax justice can therefore function as a practical compliance mechanism rather than an abstract normative aspiration.

C. Horizontal Equity, Sectoral Differences, and the Risk of Distortion

Horizontal equity requires closer attention because Indonesian UMKM do not represent a homogeneous economic population. The label UMKM encompasses enterprises operating in sectors with fundamentally different cost structures, capital intensities, competitive conditions, and profit margins. A restaurant may face substantial expenditure on ingredients, labour, rent, utilities, and spoilage, while a professional service provider may operate with relatively low marginal costs. Both may report the same annual turnover, yet their net economic capacities can differ substantially. Applying an identical turnover tax rate to both therefore creates an implicit assumption that sectoral profitability is irrelevant. Musgrave's conception of horizontal equity suggests otherwise: materially different tax treatment can be justified when taxpayers are materially different, but the relevant differences must correspond to the normative basis of taxation (Musgrave 1990). If the tax is intended to measure income, differences in profitability are directly relevant.

Sectoral differentiation is not without risks. Creating different presumptive rates for numerous industries can increase administrative complexity, generate classification disputes, and create opportunities for taxpayers to recharacterise activities to obtain lower rates. The OECD therefore warns that simplified regimes must be designed carefully to avoid introducing new distortions or complexity (OECD 2015; OECD 2024). A system with dozens of sectoral categories could undermine the very simplicity that justifies presumptive taxation. The appropriate response is therefore not unlimited differentiation but strategic differentiation. Indonesia could identify a limited number of broad sectors with systematically different cost structures and establish presumptive parameters only where empirical evidence demonstrates substantial and persistent differences. The state should avoid attempting to reproduce a full corporate income tax system through increasingly elaborate presumptive rules. The purpose of differentiation should be to correct major inequities, not to achieve perfect measurement of individual income.

Another important issue is the potential effect of the turnover threshold on business growth. A preferential tax regime can create a discontinuity when the tax consequences of exceeding a threshold become significantly greater than the benefits of expansion. Businesses may respond by delaying growth, limiting transactions, dividing operations, or maintaining multiple informal entities. The IMF has specifically identified these risks in its analysis of Indonesia and in its broader modelling of turnover-based taxation (IMF 2019; Wei and Wen 2023). Such behavioural responses are problematic because they transform a policy intended to support small businesses into a potential obstacle to productivity and formal growth. Tax justice requires that taxpayers not be structurally penalised merely because they succeed in expanding. A well-designed system should therefore ensure a sufficiently gradual transition from the presumptive regime to ordinary taxation and should minimise abrupt changes in effective tax burdens at the threshold.

The threshold problem is particularly important because the Indonesian regime has historically used a relatively high gross-turnover ceiling compared with the scale of many micro-enterprises. The IMF previously characterised Indonesia's SME turnover threshold as exceptionally high by international standards and argued that its breadth allowed many medium-sized businesses to benefit from the presumptive regime (IMF 2019). OECD research similarly indicates that simplified regimes should be carefully targeted toward taxpayers who genuinely face high compliance costs rather than extending preferential treatment to businesses that possess adequate capacity to maintain ordinary accounts (OECD 2015; OECD 2023). From a justice perspective, the concern is not that successful businesses should be taxed more simply because they are successful. Rather, preferential simplification should be targeted toward those taxpayers whose administrative constraints justify the deviation from ordinary taxation. Extending the same simplified treatment to substantially larger and more capable enterprises can create horizontal inequity between taxpayers who do and do not actually need the administrative concession.

Horizontal equity also requires considering the relationship between formal and informal businesses. A formal UMKM may bear registration, reporting, record-keeping, and tax-payment obligations that an informal competitor avoids completely. If the formal business also operates under a turnover-based regime that does not reflect its margin, its combined fiscal and compliance burden may become significant relative to informal competitors. This can weaken the incentive to formalise. At the same time, an excessively generous simplified regime may encourage larger businesses to remain within the preferential category rather than transition to the standard system. The justice problem therefore operates in both directions. The state must protect formal compliant taxpayers from unfair competition while ensuring that simplified taxation remains attractive enough for informal businesses to enter the formal economy. This requires a policy equilibrium in which the tax burden is low enough to support formalisation but sufficiently targeted to avoid subsidising businesses that no longer need the concession.

D. Administrative Simplicity, Compliance Costs, and a Differentiated Justice Framework

Administrative simplicity remains a compelling reason to preserve a presumptive regime for genuinely small businesses. Compliance costs are not merely secondary expenses; they can represent a significant proportion of the resources available to micro-enterprises. Coolidge's research demonstrates that small businesses in developing countries can face highly regressive compliance costs, particularly when taxation requires detailed accounting, repeated filings, professional assistance, and interactions with tax authorities (Coolidge 2012). OECD analysis similarly recognises that the fixed costs of tax compliance can disproportionately affect smaller enterprises and justify targeted simplification (OECD 2015). Requiring a micro-enterprise with minimal accounting capacity to calculate ordinary taxable income may therefore be formally precise but substantively unfair. The tax system would transfer significant administrative resources from the taxpayer to the state merely to obtain a more accurate measurement of a relatively small tax base. In this context, simplicity itself becomes an element of tax justice.

The appropriate reform is therefore not to replace the 0.5 percent regime with full accounting-based taxation for all UMKM. Such an approach would misunderstand the reason presumptive taxation exists. Instead, Indonesia should adopt a graduated compliance architecture in which the smallest businesses receive the greatest administrative simplification, while taxpayers approaching the upper end of the eligibility range face progressively stronger record-keeping requirements. The additional information could then support a more accurate assessment of taxable capacity without requiring the smallest enterprises to maintain sophisticated accounts. This approach would align the administrative burden with taxpayer capacity. OECD research on presumptive regimes supports this logic by emphasising that simplified taxation should be carefully targeted and accompanied by appropriate eligibility criteria and administrative safeguards (OECD 2023; OECD 2024). The central principle should be that taxpayers should not be required to bear more compliance complexity than is reasonably necessary to establish their tax liability.

Simplified record-keeping could become the institutional bridge between turnover taxation and ordinary income taxation. Instead of requiring complete accounting, the government could establish standardised records for basic categories such as sales, purchases, labour costs, rent, and major operating expenses. Taxpayers above a specified turnover level could then calculate a simplified net income by applying standardised expense ratios appropriate to broad sectors. This model would preserve many advantages of presumptive taxation because taxpayers would not need to document every individual expense, while simultaneously improving the connection between tax liability and economic capacity. International literature has considered similar forms of presumptive profit taxation and modified gross-receipts systems, particularly where administrative capacity is limited but turnover alone produces excessive inequity. The reform would therefore move Indonesia from a pure turnover proxy toward a hybrid presumptive-income model, which is more closely aligned with ability to pay while remaining administratively feasible.

Taxpayer assistance must accompany any such reform. Indonesian studies demonstrate that tax knowledge and socialisation significantly influence compliance. Yudha and Dewi found that limited knowledge of the PP No. 23 of 2018 regime affected compliance among UMKM, while Inasius similarly found tax knowledge to be an important determinant of SME compliance (Yudha and Dewi 2020; Inasius 2015). Modernisation of administration should therefore not be equated with simply moving tax obligations onto digital platforms. For micro-enterprises, digitalisation without assistance can create a new form of administrative inequality because taxpayers with limited digital literacy may face greater practical difficulties than technologically sophisticated businesses. A justice-oriented tax authority should provide accessible guidance, simplified interfaces, local assistance, and proactive communication. Tax administration should function as a service institution as well as an enforcement institution. This approach is consistent with the literature showing that trust, fairness, knowledge, and perceived institutional legitimacy contribute to voluntary compliance.

Enforcement should likewise be calibrated according to taxpayer capacity and risk. The conventional model of relying primarily on audits and sanctions may be inappropriate for micro-enterprises whose non-compliance often results from limited knowledge rather than deliberate evasion. The behavioural literature distinguishes between enforced and voluntary compliance and emphasises the interaction between tax-authority power and taxpayer trust (Kirchler, Hoelzl, and Wahl 2008). Allingham and Sandmo's classic model also demonstrates that compliance decisions are affected by the perceived probability and consequences of detection (Allingham and Sandmo 1972). For UMKM, however, a justice-oriented enforcement strategy should prioritise education and correction for minor administrative errors while reserving stronger enforcement for deliberate concealment, repeated non-compliance, or artificial business fragmentation. Such an approach is likely to be more consistent with the objective of maintaining a sustainable formal tax base because it avoids transforming ordinary administrative mistakes into a source of disengagement from the tax system.

The resulting policy framework should therefore differentiate taxpayers according to both economic capacity and administrative capacity. The smallest micro-enterprises should retain a highly simplified turnover-based regime with the existing threshold relief, because the compliance savings are most valuable at this level. Businesses with higher turnover but still limited accounting capacity could be subject to a hybrid presumptive system using simplified expense ratios or sector-based margins. Enterprises approaching or exceeding the upper threshold should gradually transition toward ordinary income taxation because their capacity to maintain records is greater and the distributive justification for preferential treatment becomes weaker. This architecture would also reduce the incentive to remain artificially small because graduation would become gradual rather than abrupt. The objective is not to eliminate simplicity but to allocate simplicity where it produces the greatest justice benefit. Such differentiation would transform the current binary distinction between final taxation and ordinary taxation into a continuum that better reflects the diversity of Indonesian UMKM.

Conclusion

Indonesia's final income tax regime for UMKM represents a legitimate response to the disproportionate administrative costs associated with conventional income taxation. The 0.5 percent turnover-based approach, together with the exemption of the first IDR 500 million of annual turnover for eligible individual taxpayers, reduces the compliance burden and can encourage formalisation, particularly among micro-enterprises with limited bookkeeping capacity. Empirical evidence from Indonesia indicates that lower tax rates, tax knowledge, perceptions of fairness, and administrative simplicity can contribute to stronger compliance. Nevertheless, the regime's principal weakness is the assumption that turnover provides a sufficiently reliable proxy for taxable capacity across diverse businesses. Identical turnover does not imply identical profitability, and a final tax imposed on gross receipts can therefore produce horizontal inequity and violate the ability-to-pay principle when profit margins differ substantially. The appropriate conclusion is not that presumptive taxation is inherently unjust, but that its legitimacy depends on the quality of the proxy, the population to which it applies, and the degree to which administrative simplicity compensates for the loss of precision.

A more just Indonesian UMKM tax system should consequently retain simplified taxation while introducing greater differentiation. The state should target the strongest administrative concessions toward genuinely micro-scale taxpayers, introduce simplified record-keeping and presumptive expense ratios for businesses with greater economic capacity, and establish a gradual transition toward ordinary income taxation as businesses grow. Sectoral differentiation should be limited and evidence-based so that it corrects major profitability differences without recreating the complexity of the ordinary tax system. Equally important, tax administration should combine enforcement with education, assistance, and accessible digital services because perceived fairness and institutional trust materially influence voluntary compliance. Tax justice should therefore be understood as a balance between simplicity and capacity, neutrality and differentiation, formalisation and protection from excessive burden. The strongest reform is not a choice between a simple tax and a fair tax; it is a system in which administrative simplicity is deliberately designed to serve substantive fairness. Such a model would allow taxation to support, rather than obstruct, the formalisation, resilience, and sustainable growth of Indonesian micro and small enterprises.

References

Allingham, Michael G., and Agnar Sandmo. 1972. "Income Tax Evasion: A Theoretical Analysis." *Journal of Public Economics* 1 (3–4): 323–338. https://doi.org/10.1016/0047-2727(72)90010-2.

Bird, Richard M., and Eric M. Zolt. 2008. "Tax Policy in Emerging Countries." *Environment and Planning C: Government and Policy* 26 (1): 73–86. https://doi.org/10.1068/cav3.

Casanegra de Jantscher, Milka, and Vito Tanzi. 1987. "Presumptive Income Taxation: Administrative, Efficiency, and Equity Aspects." IMF Working Paper 87/54. Washington, DC: International Monetary Fund. https://doi.org/10.5089/9781451969375.001.

Coolidge, Jacqueline, and Fatih Yilmaz. 2014. *Does E-Filing Reduce Tax Compliance Costs in Developing Countries?* Investment Climate in Practice No. 21. Washington, DC: World Bank Group. World Bank

Coolidge, Jacqueline. 2010. *Tax Compliance Cost Surveys: Using Data to Design Targeted Reforms*. Investment Climate in Practice Note No. 8. Washington, DC: World Bank Group.

Coolidge, Jacqueline. 2012. "Findings of Tax Compliance Cost Surveys in Developing Countries." *eJournal of Tax Research* 10 (2): 250–287. UNSW Sites

Government of Indonesia. 2018. *Government Regulation No. 23 of 2018 concerning Income Tax on Income from Businesses Received or Obtained by Taxpayers with Certain Gross Turnover*.

Government of Indonesia. 2021. *Government Regulation No. 7 of 2021 concerning the Facilitation, Protection, and Empowerment of Cooperatives and Micro, Small, and Medium Enterprises*.

Government of Indonesia. 2021. *Law No. 7 of 2021 concerning Harmonisation of Tax Regulations*.

Government of Indonesia. 2022. *Government Regulation No. 55 of 2022 concerning Adjustments to Income Tax Regulations*. Database Peraturan | JDIH BPK+1

Government of Indonesia. 2023. *Law No. 6 of 2023 concerning the Stipulation of Government Regulation in Lieu of Law No. 2 of 2022 concerning Job Creation into Law*.

Inasius, Fany. 2013. "The Implication of VAT Regulation to Tax Revenues: The Case of Small Retailer in Indonesia." *Binus Business Review* 4 (1): 147–156. https://doi.org/10.21512/bbr.v4i1.1043.

Inasius, Fany. 2015. "Tax Compliance of Small and Medium Enterprises: Evidence from Indonesia." *Accounting & Taxation* 7 (1): 67–73.

Inasius, Fany. 2019. "Factors Influencing SME Tax Compliance: Evidence from Indonesia." *International Journal of Public Administration* 42 (5): 367–379. https://doi.org/10.1080/01900692.2018.1464578.

International Monetary Fund. 2019. *Indonesia: Selected Issues*. IMF Country Report No. 19/251. Washington, DC: International Monetary Fund. https://doi.org/10.5089/9781513509136.002.

Kirchler, Erich, Erik Hoelzl, and Ingrid Wahl. 2008. "Enforced versus Voluntary Tax Compliance: The 'Slippery Slope' Framework." *Journal of Economic Psychology* 29 (2): 210–225. https://doi.org/10.1016/j.joep.2007.05.004.

Mas-Montserrat, Mariona, Cйline Colin, and Bert Brys. 2024. "The Design of Presumptive Tax Regimes in Selected Countries." *OECD Taxation Working Papers*, No. 69. Paris: OECD Publishing. https://doi.org/10.1787/58b6103c-en.

Mas-Montserrat, Mariona, Cйline Colin, Eugйnie Ribault, and Bert Brys. 2023. "The Design of Presumptive Tax Regimes." *OECD Taxation Working Papers*, No. 59. Paris: OECD Publishing. https://doi.org/10.1787/141239bb-en.

Murphy, Liam, and Thomas Nagel. 2002. *The Myth of Ownership: Taxes and Justice*. New York: Oxford University Press. https://doi.org/10.1093/0195150163.001.0001.

Musgrave, Richard A. 1990. "Horizontal Equity, Once More." *National Tax Journal* 43 (2): 113–122. https://doi.org/10.1086/NTJ41788830.

OECD. 2009. *Taxation of SMEs: Key Issues and Policy Considerations*. OECD Tax Policy Studies No. 18. Paris: OECD Publishing. https://doi.org/10.1787/9789264024748-en.

OECD. 2015. *Taxation of SMEs in OECD and G20 Countries*. OECD Tax Policy Studies No. 23. Paris: OECD Publishing. https://doi.org/10.1787/9789264243507-en.

OECD. 2017. *The Changing Tax Compliance Environment and the Role of Tax Audit*. Paris: OECD Publishing.

OECD. 2023. *The Design of Presumptive Tax Regimes*. Paris: OECD Publishing. https://doi.org/10.1787/141239bb-en.

OECD. 2024. *OECD Economic Surveys: Indonesia 2024*. Paris: OECD Publishing.

Rawls, John. 1971. *A Theory of Justice*. Cambridge, MA: Harvard University Press.

Slemrod, Joel. 2007. "Cheating Ourselves: The Economics of Tax Evasion." *Journal of Economic Perspectives* 21 (1): 25–48. https://doi.org/10.1257/jep.21.1.25.

Timothy, Joshua, and Yulianti Abbas. 2021. "Tax Morale, Perception of Justice, Trust in Public Authorities, Tax Knowledge, and Tax Compliance: A Study of Indonesian SMEs." Universitas Indonesia

Wei, Feng, and Jean-Franзois Wen. 2019. "The Optimal Turnover Threshold and Tax Rate for SMEs." IMF Working Paper 19/98. Washington, DC: International Monetary Fund.

Wei, Feng, and Jean-Fran3ois Wen. 2023. "Designing a Presumptive Income Tax Based on Turnover in Countries with Large Informal Sectors." IMF Working Paper 23/267. Washington, DC: International Monetary Fund. https://doi.org/10.5089/9798400261015.001.

Wen, Jean-Fran3ois. 2023. "How to Design a Presumptive Income Tax for Micro and Small Enterprises." IMF How-To Note 2023/002. Washington, DC: International Monetary Fund. https://doi.org/10.5089/9798400241154.061.

Wulan, Dewi Nawang, and Etik Kresnawati. 2019. "The Influence of Reducing Rates and Methods of Tax Calculation on Taxpayers Compliance of Small and Medium Micro Business: Experimental Study in Yogyakarta." *Riset Akuntansi dan Keuangan Indonesia* 4 (2).

Yeremia, Reinhard, M. Hidayat, and Handyka Prayogi Lesmana. 2023. "Justice and Tax Benefits of MSMEs in Government Regulation No. 23 of 2018." *YURISDIKSI: Jurnal Wacana Hukum dan Sains* 18 (4): 403–411. https://doi.org/10.55173/yurisdiksi.v18i4.144.

Yudha, Cokorda Krisna, and Cok Istri Ratna Sari Dewi. 2020. "Kepatuhan Wajib Pajak Pasca Aturan PP No. 23 Tahun 2018 pada UMKM Ekowisata Desa Singapadu." *E-Jurnal Akuntansi* 30 (4). https://doi.org/10.24843/EJA.2020.v30.i04.p13.

***

Acknowledgment
None

Funding Information
None

Conflicting Interest Statement
The authors state that there is no conflict of interest in the publication of this article.

Publishing Ethical and Originality Statement
All authors declared that this work is original and has never been published in any form and in any media, nor is it under consideration for publication in any journal, and all sources cited in this work refer to the basic standards of scientific citation.

Generative AI Statement
N/A