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Tax Justice and the Informal Economy in Indonesia: Rethinking Tax Obligations for Street Vendors and Micro-Entrepreneurs

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Abstract

Indonesia's informal economy provides livelihoods for a large number of workers and micro-entrepreneurs who may operate outside formal business and tax structures. Street vendors and other informal entrepreneurs frequently have limited financial capacity, unstable income, and restricted access to administrative services. This article examines whether Indonesia's tax policies adequately reflect the economic circumstances of informal workers. Using normative juridical and policy analysis, the study evaluates income taxation, business formalization, simplified tax regimes, administrative requirements, and local taxation. The article argues that tax enforcement based exclusively on formal registration may disproportionately burden vulnerable entrepreneurs while failing to address the structural causes of informality. A justice-oriented approach should distinguish deliberate tax avoidance from economic informality arising from limited administrative capacity and livelihood necessity. The study proposes a graduated tax framework combining simplified registration, low-cost compliance, taxpayer assistance, and proportional enforcement. Local governments should also coordinate taxation with programs providing legal business status, access to markets, and social protection. The article concludes that tax justice in the informal economy requires a balance between revenue mobilization and the protection of livelihood security. Tax formalization should function as a pathway toward economic inclusion rather than merely an instrument of fiscal enforcement.

[*Sektor ekonomi informal di Indonesia menjadi sumber penghidupan bagi banyak pekerja dan pelaku usaha mikro yang mungkin beroperasi di luar struktur bisnis dan perpajakan formal. Pedagang kaki lima dan pelaku usaha informal lainnya sering kali memiliki keterbatasan kemampuan finansial, pendapatan yang tidak stabil, serta akses yang terbatas terhadap layanan administrasi. Artikel ini mengkaji apakah kebijakan perpajakan Indonesia telah cukup mencerminkan kondisi ekonomi para pekerja informal. Dengan menggunakan metode yuridis normatif dan analisis kebijakan, studi ini* *mengevaluasi aspek pajak penghasilan, formalisasi usaha, rezim pajak yang disederhanakan, persyaratan administratif, dan pajak daerah. Artikel ini berargumen bahwa penegakan aturan pajak yang semata-mata didasarkan pada pendaftaran formal dapat memberikan beban yang tidak proporsional bagi pelaku usaha rentan, sekaligus gagal mengatasi akar penyebab struktural dari sifat informal usaha tersebut. Pendekatan yang berorientasi pada keadilan semestinya membedakan antara tindakan penghindaran pajak yang disengaja dengan kondisi informalitas ekonomi yang timbul akibat keterbatasan kapasitas administratif dan tuntutan pemenuhan kebutuhan hidup. Studi ini mengusulkan kerangka kerja perpajakan bertingkat yang memadukan pendaftaran yang disederhanakan, kepatuhan dengan biaya rendah, bantuan bagi wajib pajak, serta penegakan aturan yang proporsional. Pemerintah daerah juga perlu mengoordinasikan kebijakan perpajakan dengan program-program yang menyediakan status usaha legal, akses pasar, dan perlindungan sosial. Artikel ini menyimpulkan bahwa keadilan pajak dalam ekonomi informal menuntut keseimbangan antara upaya mobilisasi penerimaan negara dan perlindungan terhadap keamanan penghidupan. Formalisasi perpajakan seharusnya berfungsi sebagai jalan menuju inklusi ekonomi, bukan sekadar instrumen penegakan fiskal semata.*]

Keywords: Informal economy, street vendors, micro-enterprises, tax justice, tax formalization

Introduction

The informal economy remains a structural component of Indonesia's economic and social landscape. Street vendors, small food sellers, home-based producers, informal traders, independent service providers, market sellers, repair workers, and other micro-entrepreneurs generate income outside the organizational structures normally associated with formal businesses. Their activities provide employment and household income while supplying relatively inexpensive goods and services to urban and rural communities. The significance of informal economic activity is therefore not adequately captured by its absence from formal registration systems. Informality represents a substantial sphere of economic activity in which individuals create livelihoods through markets that are frequently characterized by low entry barriers, limited capital, flexible working arrangements, and weak institutional protection.

The empirical importance of this sector is reflected in Indonesia's labor statistics. The Central Statistics Agency (BPS) separately monitors self-employed and casual workers because their employment and income conditions differ from those of formal wage and salary workers. BPS's *Income Statistics February 2024*, for example, emphasizes the relatively limited legal and economic protection available to non-employee workers and provides income statistics for self-employed and free workers based on the National Labor Force Survey. The World Bank's 2023

Informal Sector Enterprise Survey likewise treats businesses without relevant formal registration as part of Indonesia's informal business population and collected data across several major Indonesian cities, including Jakarta, Surabaya, Medan, Makassar, Denpasar, and Pontianak.

The persistence of informality presents a difficult challenge for tax policy. From the perspective of fiscal capacity, governments have an interest in expanding the tax base and ensuring that individuals with taxable economic capacity contribute to public expenditure. From the perspective of social justice, however, taxation should not disregard the economic vulnerability and administrative limitations of micro-entrepreneurs. A street vendor whose daily revenue fluctuates according to weather, location, purchasing power, and local market conditions is economically different from an established retail enterprise with accounting personnel, bank financing, permanent premises, and predictable revenue. Applying identical compliance requirements to both may satisfy a narrow conception of formal equality while producing substantive inequality.

This distinction is fundamental to the concept of tax justice. Tax justice requires that taxation distribute public burdens according to relevant differences in economic capacity while ensuring that similarly situated taxpayers are treated consistently. Musgrave (1959) identifies the distribution of tax burdens as a central function of public finance, while Rawls (1971) provides a broader normative framework in which institutions should be evaluated according to their implications for fairness and the position of less advantaged members of society. In tax policy, these principles are reflected through horizontal equity, vertical equity, ability to pay, and proportionality. A tax system may therefore be formally universal while remaining substantively unjust if its compliance costs disproportionately affect taxpayers with the weakest economic and administrative capacity.

The informal economy also challenges the assumption that non-registration necessarily represents deliberate tax avoidance. De Soto (1989) famously argues that informality in developing countries may emerge because legal and bureaucratic systems impose substantial costs on small entrepreneurs, making formalization difficult or unattractive. This perspective is important for Indonesia because an entrepreneur may remain informal not because the individual rejects taxation but because registration, licensing, bookkeeping, reporting, and other regulatory requirements appear disconnected from the immediate needs of livelihood generation. In this context, formalization policy that relies primarily on enforcement may unintentionally increase the cost of economic survival without addressing the structural factors that reproduce informality.

The relationship between informality and taxation is consequently more complex than a simple distinction between compliant and non-compliant taxpayers. Torgler and Schneider (2009) demonstrate that tax morale and institutional quality are closely associated with the size of the shadow economy. Their findings suggest that improving compliance requires more than increasing the probability of detection; institutional legitimacy and taxpayers' perceptions of government also matter. Similarly, Kirchler (2007) and Kirchler, Hoelzl, and Wahl (2008) demonstrate that voluntary compliance depends partly on trust, perceived fairness, and the relationship between taxpayers and tax authorities. A taxpayer who perceives the tax system as fair and administratively accessible may be more willing to comply than one who experiences taxation primarily as a coercive burden.

Indonesia has attempted to respond to these challenges through simplified taxation for micro, small, and medium enterprises. The development from Government Regulation No. 23 of 2018 to Government Regulation No. 55 of 2022 demonstrates a policy shift toward simplified taxation based on gross turnover. Under the framework of PP No. 55 of 2022, qualifying individual taxpayers operating businesses under the specified turnover threshold receive an exemption from income tax on the first IDR 500 million of annual gross turnover, while the applicable final income-tax rate for the relevant turnover regime is 0.5 percent. The Directorate General of Taxes explains that the 0.5 percent rate applies only to the portion of qualifying turnover above IDR 500 million for individual taxpayers.

This policy represents an important recognition of proportionality. Nevertheless, tax neutrality and formal simplification do not automatically eliminate the burdens associated with formalization. Even taxpayers whose turnover does not generate income-tax liability may still have registration, reporting, and record-keeping responsibilities. The Directorate General of Taxes has explicitly explained that individual entrepreneurs whose annual turnover does not exceed IDR 500 million may have no income tax payable but remain subject to annual tax-reporting and turnover-recording requirements. Direktorat Jenderal Pajak This distinction between tax payment and tax compliance is central to the present study. A taxpayer may have no tax payable while still facing administrative obligations, and these obligations can become significant for individuals with low digital literacy, limited accounting knowledge, or unstable business operations.

The OECD has similarly emphasized that small businesses face relatively high fixed costs of tax and regulatory compliance compared with their economic scale. Its comparative analysis of SME taxation concludes that tax systems should consider simplification measures while avoiding unnecessary distortions and complexity (OECD 2015). The OECD's work on tax compliance by design further argues that tax systems should be integrated into the ordinary financial systems through which businesses operate so that compliance becomes less dependent on taxpayers' capacity to understand complex administrative procedures (OECD 2014).

The Indonesian case therefore raises an important normative question: should tax policy treat informality primarily as a compliance problem or as a structural condition requiring institutional inclusion? This article argues that the latter approach provides a stronger foundation for tax justice. Enforcement remains necessary where taxpayers possess genuine taxable capacity and deliberately conceal economic activity. However, enforcement should distinguish intentional tax evasion from livelihood-driven informality, administrative incapacity, and economic vulnerability.

This article contributes to the literature by reframing tax formalization as a component of distributive and procedural justice. Rather than asking only how the state can increase tax collection from informal businesses, the article asks whether the process through which informal entrepreneurs are brought into the tax system is proportionate, accessible, and socially legitimate. The analysis focuses specifically on street vendors and micro-entrepreneurs because these groups illustrate the tension between tax administration and livelihood security most clearly.

The article addresses three interconnected questions. First, how should Indonesian tax law conceptualize the relationship between informality and tax obligations? Second, to what extent do simplified taxation and formalization policies reflect the economic and administrative circumstances of micro-entrepreneurs? Third, what institutional framework could reconcile revenue mobilization with livelihood protection and gradual formalization?

This study uses a normative juridical and policy-analysis method. The normative juridical component examines Indonesian legislation concerning income taxation, micro and small enterprises, business registration, tax administration, and local government authority. Particular attention is given to Law No. 7 of 1983 on Income Tax as amended, Law No. 7 of 2021 on Harmonization of Tax Regulations, Government Regulation No. 55 of 2022, and Minister of Finance Regulation No. 164 of 2023 concerning income taxation for taxpayers with specified gross turnover.

The policy analysis evaluates these legal instruments using the concepts of distributive justice, horizontal and vertical equity, ability to pay, proportionality, tax morale, and formalization. The analysis also draws upon empirical and comparative studies published by the OECD, World Bank, BPS, and academic scholars concerning informal employment, SME taxation, tax compliance, institutional quality, and formalization. The research is doctrinal and analytical rather than empirical; it does not attempt to estimate the aggregate tax gap of Indonesia's informal economy. Its objective is to evaluate whether the existing legal and administrative architecture is capable of achieving a balance between fiscal interests and livelihood security.

Informality, Tax Justice, and the Limits of Formal Equality

The first difficulty in designing tax policy for the informal economy is conceptual. Informality is frequently treated as synonymous with illegality or tax evasion, but this equation is analytically and normatively problematic. An informal enterprise may simply be an enterprise that operates without formal registration or outside certain regulatory structures. The World Bank's Indonesia Informal Sector Enterprise Survey, for example, defines informal businesses for survey purposes largely through the absence of relevant formal registration, illustrating that informality is fundamentally a legal and institutional status rather than proof of criminal intent. The distinction matters because tax evasion involves a deliberate attempt to defeat a known tax obligation, whereas informality may result from lack of knowledge, financial constraints, regulatory barriers, uncertainty, or the need to secure immediate household income.

De Soto's (1989) institutional explanation remains relevant in this respect. He argues that entrepreneurs may operate outside formal structures when legal procedures and bureaucratic requirements become too costly relative to the expected benefits of formalization. Informality therefore cannot be addressed exclusively by increasing penalties. If formalization provides little immediate economic benefit while imposing significant registration and compliance costs, rational micro-entrepreneurs may continue to operate outside formal structures even when they are aware of government requirements.

This insight challenges a purely enforcement-based conception of tax justice. The state has a legitimate interest in collecting taxes from individuals who possess taxable capacity, but the legitimacy of taxation also depends on proportionality. A street vendor who earns irregular daily income and has no employees cannot reasonably be presumed to possess the same administrative capacity as a formally established company. The relevant difference is not simply the legal form of the taxpayer but the taxpayer's economic circumstances.

The principle of horizontal equity requires similarly situated taxpayers to be treated similarly, but it does not require dissimilar taxpayers to be treated identically. A micro-entrepreneur and a large corporation are not similarly situated merely because both sell goods. Their capacity to bear tax and compliance costs differs substantially. Vertical equity consequently requires tax obligations to reflect differences in economic capacity. Progressive income taxation embodies this principle at the level of taxable income, but tax justice must also consider the administrative burden imposed by the tax system.

This point is particularly significant because compliance costs can function as a regressive burden. A fixed compliance requirement has a much larger relative impact on a micro-enterprise than on a large business. If a small street vendor must spend substantial time learning tax procedures, obtaining digital access, maintaining records, submitting reports, and interacting with several government institutions, the opportunity cost may represent a significant share of the entrepreneur's available working time. OECD research on SME taxation explicitly identifies higher fixed compliance costs as a structural issue affecting small businesses and argues for carefully targeted simplification (OECD 2015).

The problem becomes more complicated when tax registration is disconnected from immediate public benefits. Formalization is more likely to be accepted when entrepreneurs perceive that registration provides access to credit, markets, legal protection, government procurement, social security, training, or infrastructure. Formalization that merely increases the state's ability to monitor and tax a business without increasing the business's economic opportunities can generate resistance. The World Bank's research on Indonesian SMEs has similarly identified gaps in taxpayer knowledge and capacity as important obstacles to compliance. The evidence suggests that many small businesses do not fully understand tax requirements or the benefits associated with formalization, while willingness to comply may be associated with citizenship obligations and access to business permits rather than fear of penalties alone.

Tax morale consequently becomes central to informal-sector taxation. Torgler and Schneider (2009) find that higher tax morale and stronger institutional quality are associated with a smaller shadow economy. The implication for Indonesia is that enforcement and institutional legitimacy should be complementary rather than competing strategies. If street vendors perceive tax authorities as accessible, predictable, respectful, and helpful, formalization may become associated with citizenship and economic inclusion rather than punishment.

The same argument follows from the slippery-slope framework developed by Kirchler, Hoelzl, and Wahl (2008). Compliance is strongest when the authority possesses sufficient power to enforce the law while taxpayers simultaneously perceive the authority as legitimate and trustworthy. Excessive coercion can be counterproductive if it undermines trust. Conversely, voluntary compliance without credible enforcement can create opportunities for deliberate evasion. A justice-oriented informal-sector policy should therefore distinguish between capacity constraints and intentional non-compliance.

This distinction provides the normative foundation for differentiated enforcement. A newly registered street vendor who has failed to submit a report because of limited knowledge should initially receive assistance and an opportunity to correct the failure. An established entrepreneur who systematically conceals substantial turnover through multiple accounts or deliberately falsifies records represents a fundamentally different compliance risk. Treating both cases identically would not strengthen tax justice; it would undermine proportionality.

Indonesia's Simplified Tax Regime and the Problem of Administrative Proportionality

Indonesia has already recognized the need to adapt taxation to the economic circumstances of micro and small enterprises. Government Regulation No. 55 of 2022 provides a simplified final income-tax regime for taxpayers with specified gross turnover. For qualifying individual taxpayers, gross turnover up to IDR 500 million in a tax year is not subject to income tax, while the 0.5 percent final rate applies to the portion exceeding that amount within the relevant regime. The policy is explicitly intended to prevent very small businesses from facing disproportionate income-tax burdens.

From a tax-justice perspective, the IDR 500 million exemption is significant because it recognizes that gross turnover does not equal economic capacity. A business may generate turnover while retaining only a relatively small margin after purchasing inventory, transportation, rent, utilities, family labor, and other expenses. Exempting the first IDR 500 million of turnover for qualifying individual taxpayers therefore creates a buffer that reduces the likelihood that the smallest entrepreneurs will be taxed on economic activity that primarily supports subsistence.

The 0.5 percent final tax regime also reduces administrative complexity because the taxpayer does not have to calculate ordinary taxable profit under the general income-tax system. This is particularly relevant to entrepreneurs without accounting expertise. The OECD's research on SME taxation supports such simplification where fixed compliance costs disproportionately affect small enterprises (OECD 2015). Similarly, the OECD's "tax compliance by design" approach argues that tax systems should be embedded into the financial and administrative systems used by businesses rather than requiring taxpayers to construct separate compliance processes (OECD 2014).

However, simplification should not be confused with the complete elimination of administrative burdens. Under the Indonesian framework, an individual entrepreneur with turnover below the IDR 500 million threshold may have no income tax payable but can still be required to maintain records and submit an annual tax return. The Directorate General of Taxes explicitly explains that the absence of income-tax liability does not automatically eliminate reporting obligations. This creates an important distinction between substantive tax relief and procedural compliance.

From the perspective of administrative justice, this distinction requires careful evaluation. A taxpayer with no tax payable may reasonably question why substantial reporting obligations remain necessary. The answer is that the tax authority requires information to determine whether the taxpayer actually falls below the threshold and to maintain an auditable tax system. Nevertheless, the requirement should be implemented through the least burdensome mechanism available. If digital records, simplified turnover declarations, or pre-filled reporting can accomplish the same administrative objective, requiring extensive documentation would be difficult to justify under a proportionality principle.

The World Bank's evidence concerning Indonesian SMEs reinforces this point. Research on tax compliance among Indonesian SMEs has identified limited knowledge, limited access to administrative resources, and uncertainty concerning tax obligations as important barriers to compliance. A randomized intervention involving Indonesian SMEs also suggests that the content and framing of tax messages can influence taxpayer behavior. Information about the public-good function of taxation can complement simple payment instructions and deterrence messages. World Bank This supports a model of tax administration in which education and assistance are treated as components of compliance policy rather than as optional public-relations activities.

The Business Development Service approach adopted by the Directorate General of Taxes is therefore important. The tax authority has developed programs intended to provide guidance and assistance to MSMEs, alongside the tax facilities provided under the HPP Law and PP No. 55 of 2022. Direktorat Jenderal Pajak Such programs reflect a broader conception of tax administration in which the state does not simply identify taxpayers and demand payment but also assists them in developing the capacity required to operate within the formal economy.

Nevertheless, the simplified tax regime also presents a potential justice concern because turnover-based taxation does not perfectly correspond to ability to pay. Two businesses with identical turnover can have substantially different profit margins. A street-food seller, for example, may have a different cost structure from a digital service provider. The final-tax mechanism sacrifices some precision in exchange for simplicity. This trade-off is defensible for micro-enterprises where the administrative cost of measuring actual profit may exceed the revenue benefit, but it should be continuously evaluated to ensure that simplification does not become regressive.

The appropriate principle is therefore administrative proportionality. The smaller and less complex the business, the stronger the justification for simplified registration, simplified records, simplified reporting, and taxpayer assistance. As businesses become larger and more profitable, the justification for more comprehensive accounting and reporting increases. Such graduated administration is consistent with OECD analysis of SME taxation and with the broader principle that tax administration should allocate enforcement resources according to risk and economic significance (OECD 2015; OECD 2016).

From Tax Enforcement to Inclusive Formalization: A Justice-Oriented Framework

The central policy implication of the preceding analysis is that Indonesia should rethink formalization as an institutional process rather than a single registration event. Formalization should not end when a micro-entrepreneur obtains a taxpayer identification number or business registration. Instead, formalization should be understood as a gradual transition in which entrepreneurs receive increasing access to legal status, markets, finance, social protection, government services, and tax obligations as their economic capacity develops.

This approach is consistent with the idea that taxation is part of a broader social contract. Taxes finance public services and infrastructure, but the legitimacy of taxation depends on whether taxpayers perceive a reciprocal relationship between contributions and public institutions. The OECD's work on taxpayer education emphasizes that a sustainable tax culture requires citizens to understand both their rights and responsibilities and to perceive taxation as part of their relationship with government (OECD/FIIAPP 2015). In the context of street vendors and micro-entrepreneurs, this relationship is especially important because their interaction with government may otherwise be limited to licensing requirements, enforcement operations, and tax demands.

An inclusive formalization strategy should therefore connect tax registration with tangible economic benefits. A street vendor who enters the formal system should ideally gain access to legally recognized trading locations, digital payment infrastructure, government-supported marketplaces, business-development assistance, social-security programs, and financial services. The objective is not to "reward" taxpayers for compliance in an arbitrary manner but to recognize that formalization generates public and private benefits when institutions are designed to make legal economic participation worthwhile.

This is particularly important because formalization can impose risks as well as benefits. Once a micro-business becomes visible to government institutions, the entrepreneur may fear increased taxation, regulatory inspection, or administrative sanctions. If the expected costs exceed the expected benefits, informality can remain economically rational. De Soto's (1989) argument concerning the cost of formal legal systems is therefore still relevant. Formalization policy should reduce the transaction costs associated with entering and remaining in the formal economy.

The tax authority's role should consequently shift from a model based predominantly on post-factum enforcement toward a combination of assistance, digital facilitation, risk-based enforcement, and gradual escalation. For the smallest entrepreneurs, registration and reporting should be as simple as possible. Digital platforms could provide integrated registration and turnover-recording tools, while local government offices could coordinate business licensing with tax administration. Where entrepreneurs lack digital access, assisted registration and physical service points remain necessary because digitalization can itself create exclusion.

The local dimension is particularly important for street vendors. Local governments frequently regulate the use of public spaces, market locations, sanitation, licensing, and business activities. Consequently, a street vendor may face obligations arising from national income taxation and separate local regulatory frameworks. If these systems operate independently, entrepreneurs may encounter multiple registrations, fees, inspections, and reporting requirements. A justice-oriented approach should seek administrative coordination so that formalization becomes a single, comprehensible process rather than a collection of disconnected obligations.

The distinction between taxation and local charges must also remain clear. Not every payment required by a local government constitutes income taxation. Local governments may impose taxes or levies within the framework established by national law, but such instruments should not cumulatively create a burden that undermines the viability of micro-enterprises. The broader principle of fiscal decentralization requires local revenue mobilization to be balanced against economic development and equity objectives.

A further concern is the risk of selective enforcement. Informal businesses often operate in visible public locations, making street vendors easier to observe than larger forms of economic activity. Visibility, however, should not be confused with greater tax capacity. A vendor selling food on a sidewalk may be more easily detected by local officials than an unregistered online service provider, but this does not justify concentrating enforcement on the most visible entrepreneurs. Tax justice requires enforcement to be based on economic capacity and compliance risk rather than merely on physical visibility.

This principle also supports a distinction between formalization failure and tax evasion. Where an entrepreneur has never registered because of lack of knowledge or administrative access, the first response should ordinarily be registration assistance and education. Where a business has significant economic capacity and deliberately structures transactions to conceal taxable income, stronger enforcement is justified. Such differentiation improves both fairness and the efficiency of enforcement resources.

The role of taxpayer education is therefore central. OECD research emphasizes that education can strengthen tax culture and compliance by explaining not only how to comply but also why taxation matters (OECD/FIIAPP 2015). OECD In Indonesia, taxpayer education should be designed around the actual circumstances of micro-entrepreneurs rather than around technical tax terminology. A street vendor needs to know when registration is required, whether the first IDR 500 million of annual turnover is subject to income tax, how to record daily turnover, how to submit an annual return, and where to obtain assistance. Such information is more likely to generate compliance than abstract explanations of tax law.

Technology can further reduce the administrative burden. OECD research on tax services for SMEs suggests that online accounting, mobile technology, and machine-to-machine communication can create more integrated tax systems and improve compliance, particularly in developing and emerging economies where conventional tax-service infrastructure may be limited (OECD 2016). For Indonesian micro-entrepreneurs, simple mobile-based turnover recording and automated reporting could reduce the need for professional tax assistance. However, digital solutions should remain optional or supported by assisted channels for taxpayers who lack reliable internet access or digital literacy.

The broader objective should be a graduated tax formalization model. At the lowest level, the state should prioritize identification, basic registration, taxpayer education, and access to services. At the next stage, when economic activity becomes more stable, simplified tax obligations should apply. As turnover and economic complexity increase, the entrepreneur should gradually transition toward more comprehensive accounting and ordinary tax administration. Enforcement should escalate correspondingly when there is evidence of deliberate non-compliance. Such a framework recognizes that formalization is a process rather than a binary condition.

This model also aligns with the emerging international understanding that informal and hard-to-tax sectors should not be treated as a single homogeneous category. OECD work on taxation in developing economies increasingly distinguishes between informal activity, difficult-to-tax activity, and deliberate non-compliance. The distinction is analytically important because different categories require different policy responses. Although that particular OECD analysis extends beyond the 2025 literature boundary in its final publication, the conceptual distinction is consistent with the pre-2025 literature on informal-sector taxation and is useful for interpreting Indonesia's policy challenges.

The ultimate measure of success should therefore not be the number of informal entrepreneurs converted into registered taxpayers. A registration statistic alone may indicate administrative expansion without demonstrating improved welfare. A more meaningful evaluation should consider whether formalization increases access to finance, improves business survival, expands market access, increases social protection, strengthens public-service access, and creates sustainable tax capacity. Tax formalization is successful when legal recognition and taxation become part of economic inclusion rather than merely mechanisms of surveillance.

In this sense, tax justice requires a reciprocal transformation. Informal entrepreneurs should assume progressively greater fiscal responsibilities as their economic capacity increases, while the state should provide institutional conditions that make formalization economically meaningful. This reciprocal relationship is more likely to generate sustainable compliance than a strategy centered exclusively on penalties. As Torgler and Schneider (2009) demonstrate, tax morale and institutional quality are important determinants of the shadow economy. The Indonesian tax system can therefore reduce informality more effectively by improving both the capacity of taxpayers to comply and their confidence that compliance is legitimate.

Conclusion

Indonesia's informal economy presents a fundamental challenge to conventional approaches to tax administration because informality cannot be equated automatically with tax evasion. Street vendors and micro-entrepreneurs frequently operate under conditions of unstable income, limited capital, restricted administrative capacity, and weak access to formal markets and institutional services. From the perspective of tax justice, these circumstances matter because formal equality can produce substantive inequality when taxpayers with dramatically different economic and administrative capacities are subjected to comparable compliance burdens. Indonesia's simplified taxation regime under Government Regulation No. 55 of 2022 represents an important movement toward proportionality, particularly through the exclusion of the first IDR 500 million of annual turnover from income tax for qualifying individual taxpayers and the simplified 0.5 percent final tax mechanism applicable within the relevant regime. Nevertheless, the existence of simplified tax rates does not eliminate the broader administrative challenges of registration, record keeping, reporting, licensing, and interaction with multiple government institutions.

A justice-oriented approach should therefore redefine tax formalization as a gradual process of economic inclusion rather than an enforcement event. The state should distinguish deliberate tax evasion from informality caused by limited knowledge, administrative barriers, and livelihood necessity. Tax compliance should be graduated according to economic scale and complexity, with simplified registration, low-cost reporting, taxpayer assistance, digital facilitation, and access to markets and social protection for the smallest entrepreneurs, while stronger documentation and enforcement should apply as economic capacity and compliance risk increase. Such a framework would reconcile fiscal objectives with livelihood security and strengthen the legitimacy of taxation. The ultimate objective should not simply be to maximize the number of registered taxpayers but to create a formal economic environment in which registration provides tangible benefits, taxation is proportionate to ability to pay, and entrepreneurs have a realistic pathway from subsistence activity toward sustainable formal enterprise. In this model, tax formalization becomes an instrument of inclusive development rather than merely an instrument of fiscal extraction.

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