

P R A K A R S A *Policy Brief*

November 2022

Wealth tax: Assessing the potential and opportunities of the implementation in Indonesia

Key Points:

- The inequality during the COVID-19 pandemic escalated as the poverty rate rose, yet, at the same time, the number of HNWI (High-Net-Worth Individuals) in Indonesia and their wealth increased.
- Imposing higher taxes on HNWI is estimated to significantly add approximately IDR54 trillion to IDR155.3 trillion for a single imposition.
- The wealth tax format with a progressive rate of one to two percent for HNWI with a net worth above IDR144 billion is the most likely to be applied in Indonesia.



COVID-19 pandemic, inequality, and fiscal conditions in Indonesia

Poverty and inequality showed an increase during the initial period of the COVID-19 pandemic. The number of people living in poverty rose from 26.42 million in March 2020 to 27.54 million in March 2021. Moreover, Statistics Indonesia (BPS) reported a Gini ratio of 0.385 in September 2020, indicating a higher inequality compared to that in the pandemic's initial period, where the ratio was 0.381 in March 2020, and that before the pandemic, where the ratio was 0.380 in September 2019 (BPS, 2022).

The gain in the number of rich people and their nominal wealth during the COVID-19 pandemic also indicated an increase in inequality. Credit Suisse Research Institute (2021), a Swiss investment institution, stated that the number of Indonesia's High-Net-Worth Individuals (HNWIs) is rising. The number of Indonesian people with wealth over US\$1 million was close to 172,000 in 2020, increased by 62 percent compared to 2019. In addition, Forbes (2022) noted that the combined total net assets of the 50 richest people in Indonesia increased by 22 percent from US\$133 billion (approximately IDR1.938 trillion) in 2020 to US\$162 billion (approximately IDR2.324 trillion) in 2021, nearly equivalent to Indonesia's 2020 State Revenue and Expenditure Budget (APBN).

The COVID-19 pandemic also affected Indonesia's fiscal capacity. The state revenue decreased from IDR2,233.1 trillion (in the 2020 State Budget Law) to IDR1,699.9 trillion (in Presidential Decree No.

72 of 2020). The decline in community economic activities indirectly reduced tax revenue, the main source of state revenue. Meanwhile, the state expenditure increased from IDR2,540.4 trillion (in the 2020 State Budget Law) to IDR2,739.2 trillion (in Presidential Decree No. 72 of 2020). The increase in state expenditure was allocated to encounter the unexpected impact of the COVID-19 pandemic on the health, economic, and social sectors (Ministry of Finance, 2022). The revenue decrease and the expenditure increase have encouraged the government to find alternative funding sources (Ministry of Finance, 2022). Accordingly, wealth tax is thought to become an alternative source of funds.

Wealth tax can be allocated to reduce inequality

Wealth tax is considered one of the potential instruments in wealth redistribution and overcoming inequality. Wealth tax is nothing new as the International Monetary Fund (IMF) and several academics have been campaigning for a progressive wealth and income tax to reduce the existing inequality and optimize fiscal capacity (Advani et al., 2020). In a petition organized by Millionaires for Humanity, 150 billionaires worldwide have signed to implement a wealth tax to overcome the COVID-19 pandemic and aid the economic recovery. Two well-known economists supporting the petition were Jeffrey Sachs and Gabriel Zucman (PRAKARSA, 2021).

The community supports the implementation of wealth tax for economic development and the

COVID-19 pandemic recovery. The survey involving 1,051 respondents conducted by Glocalities and Millionaires for Humanity (2021, in PRAKARSA, 2021) found that 79 percent of respondents supported the imposition of a wealth tax on Indonesian citizens with assets of more than IDR140 billion at an annual flat rate of one percent. The survey result confirmed that the community highly supported the wealth tax implementation as a wealth redistribution effort.

Wealth tax must be utilized to solve economic problems, especially inequality. Piketty (2015) believed that economic inequality would continue to exist and widely diffuse unless there was political intervention by implementing a wealth tax. Furthermore, Piketty emphasized the need to implement wealth tax alongside income tax implementation. Wealth tax is a broad-based tax on net worth ownership. Broad-based means that taxes are imposed on all types of assets and net worth (assets minus debt) (Advani et al., 2020). According to Actionaid (2018), wealth tax can be imposed on wealth ownership, wealth transfer, or wealth appreciation. Taxes on net worth are derived from taxes on a number of assets, including, but not limited to, savings/giro, bank deposits, shares, vehicles, estimated property values, and so forth.

Pros and cons of wealth tax arguments

Wealth tax holds its pros and cons, considering its relevance and socio-economic impact. On the one hand, the arguments supporting wealth tax implementation are more relevant during the COVID-19 pandemic. The governments of numerous countries encounter financial difficulties due to the unexpected crisis and the impact of the economic slowdown. The increase in the number of new HNWIs and the wealth of old HNWIs during the crisis become the main reasons behind choosing wealth tax to boost state income, protect the bottom of the pyramid, and reduce inequality. According to an estimation presented by the University of Greenwich, France, a progressive tax on net worth can generate income between three percent and 10.8 percent of GDP (Kapeller et al., 2021).

On the other hand, the arguments against wealth tax believe that wealth tax can increase business risks and reduce innovation, which may impact long-term growth (OECD, 2018). If returns on savings and investment are taxed, the decision to defer resource consumption and allocation over time will be taken. Arguments against wealth tax tend to be associated with capital flight, disincentives for investment behavior, and increased tax avoidance practices, considering that all countries have their own tax policies and, especially, the existence of tax haven countries.

Apart from the pros and cons above, wealth tax contributes to the relative state revenue for the implementing countries depending on their political ecosystem of the wealth tax. In France, the wealth tax only contributed 0.19 percent of state revenue in 2020, while in Switzerland, the contribution of wealth tax to state revenue reached 5.12 percent in the same year (Bunn, 2022). The diversity in the state revenue is affected by various factors, especially the design of the wealth tax in each country.

Simulation of potential wealth tax revenue in Indonesia

This simulation aims to measure the potential of wealth tax in Indonesia and find the most likely model to be applied in Indonesia. This simulation highlights four main scenarios adopting different tariffs and models used by a number of countries. The calculation of potential revenue presented in Forbes and Statista data in 2021. These two sources process data and information from other secondary sources, i.e., Credit Suisse and Knight Frank. Through these two data sources, it is estimated that there are around 10,700 taxpayers subject to wealth tax in Indonesia.

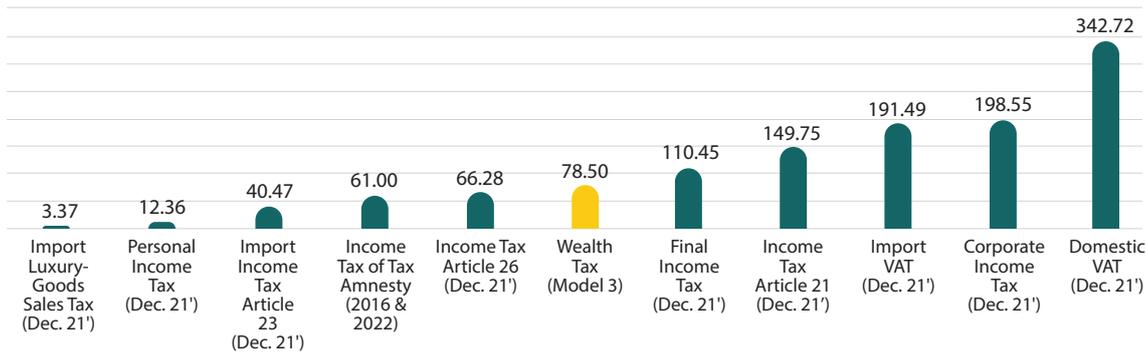
In 2021, Forbes provided detailed information about the total wealth of the 100 richest people in Indonesia. Meanwhile, Statista reveals aggregate data regarding the number of billionaires with wealth above US\$1 million (approximately IDR14.4 billion with the exchange rate of US\$1 = IDR14,400), which amounts to approximately 21,500 people. The simulation of calculating the potential tax revenue was carried out by assuming that around 4,600 people have wealth exceeding US\$10 million or IDR144 billion as the threshold for the wealth tax rate.

The simulation results based on 4 scenario or model indicate that:

- Model 1 (Flat 1%): The potential tax revenue is IDR54 trillion. By using Forbes data, the simulation estimates tax revenue of around IDR27.9 trillion from Indonesia's 100 richest people. Meanwhile, the rest is estimated to contribute as much as IDR26.2 trillion. When adopting the realization of Indonesia's tax revenue in 2021, this model's wealth tax contributes 4.23 percent to the total tax revenue.
- Model 2 (Flat 2%): The potential tax revenue is IDR86.6 trillion. The 100 richest people are estimated to contribute IDR55.7 trillion, and the rest are estimated to contribute IDR30.9 trillion. According to this result, the wealth tax contributes 6.78 percent to the realization of tax revenue in 2021.
- Model 3 (Progresif 1% - 2%): The potential tax revenue is IDR78.5 trillion. The 100 richest people are estimated to contribute IDR60.2 trillion, and the rest are estimated to contribute IDR18.4 trillion. It is equivalent to 6.15 percent of the realization of Indonesia's tax revenues in 2021.
- Model 4 (Progresif 1,5% - 4%): The potential tax revenue is IDR155.3 trillion. The 100 richest people are estimated to contribute IDR123.4 trillion, and the other groups below are estimated to contribute IDR31.9 trillion. It is equivalent to 12.15 percent of the realization of Indonesia's tax revenues in 2021.

The potential wealth tax is estimated to range from IDR54 trillion to IDR155.3 trillion for one-time imposition. Based on the four models above, model 3 (with a progressive rate of 1 - 2% and a cut-off net worth of IDR144 billion) is the most likely to be implemented in Indonesia. Additionally, such a tax rate remains effectively applied in several OECD countries, such as Switzerland and Norway.

Chart 1. Illustration of the 2021 Tax Revenue Realization and Potential Wealth Tax (trillion rupiahs)



Source: MoF, processed data (2022)

Applying the simple calculation of model 3 above and the ceteris paribus assumption can significantly add 6.15 percent of total tax revenue in 2021 and 0.46 percent of GDP. Further, the potential revenue possibly reaches 6 (six) times compared to the realization of Personal Income Tax (PPh OP) of non-employees or the rich. This revenue is also equivalent to 55.9 percent of employees' realization of Personal Income Tax (PPh OP). Though the calculation adopts a simple method, it is expected to provide a realistic illustration of tax revenue increase and its comparison with the previous year's tax revenue.

Challenges and risks of implementing a wealth tax in Indonesia

The discourse on implementing a wealth tax encounters several challenges and risks. **First**, the wealth tax requires a more complex tax administration system, particularly in estimating the value of assets considered tax objects. In terms of valuation, no mechanism can identify changes in the added value of an asset. **Second**, the imposition of wealth tax is concerned about triggering capital flight abroad. HNWI's have the power for tax planning to hide assets or transfer assets. Such a fact is also raised by the policy gap among countries, including tax treaties or tariff wars between countries, such as corporate income tax.

Third, the wealth tax implementation is also concerned about raising resistance due to double taxation. The calculation of the basis of wealth or the imposition of different tax objects from each type of income or asset is feared to cause recurrent taxes or double taxes, in which the multiple effects actually trigger inequality in the proportion of tax payments.

Conclusions and Recommendations

The implementation of the wealth tax is increasingly finding its relevance during the COVID-19 pandemic. The Government can consider a wealth tax as a new type of tax since it can potentially increase state revenue. The simulation of the four calculation models provides an additional value between IDR54 trillion to IDR155.3 trillion for a one-time imposition or between 4% - 12% of the total tax revenue in 2021. This potential can be higher than the realization of Personal Income Tax (PPh OP) for non-employees or the rich (HNWI).

The followings are several recommendations regarding the implementation of a wealth tax:

- **Optimizing tax revenue from individual taxpayers by creating one integrated data.** The Ministry of Home Affairs and the Ministry of Finance shall ensure that population identity data are integrated with taxpayer data by 2023. In addition, the Directorate General of Taxes (DGT) shall register taxpayers subject to wealth tax and calculate the taxpayer's liquid assets. Furthermore, to comply with the asset value reporting system in the annual tax return that applies the acquisition value, the imposition of wealth tax also applies the acquisition value of assets, the objects of wealth tax. A wealth tax is imposed on net worth based on the acquisition value of all assets for the year before the wealth tax collection.
- **Applying a wealth tax format with a progressive rate of one to two percent annually to HNWI's with a net worth greater than or equal to IDR144 billion.** The implementation of wealth tax in this model does not hinder the wealth growth of taxpayers subject to the wealth tax. To maintain the liquidity of taxpayers, a wealth tax can be paid in installments for a maximum of three years without fines or interest. Imposing sanctions, such as fines or interest, shall apply in the event the payment exceeds three years. The net worth includes a combined total wealth of assets of savings/ giro, deposits, shares, precious metals, donations, inheritance, and grants. The wealth tax shall be imposed on these objects since if it is only imposed on one of them, the taxpayers might transfer wealth from one asset subject to wealth tax to another asset other than the object of a wealth tax.

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Managing Director :

Ah Maftuchan

The PRAKARSA Executive Director

Written by :

- Eka Afrina Djamhari
- Irvan Tengku Harja
- Rizky Deco Praha

Reviewed by:

- Victoria Fanggalda
- Herni Ramdhaningrum

Designed oleh:

Bambang Nurjaman

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P R A K A R S A

Welfare Initiative for Better Societies

Jl. Rawa Bambu I Blok A No.8-E
Pasar Minggu, Jakarta Selatan
Indonesia 12520

Phone +6221 781 1798
perkumpulan@theprakarsa.org

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