

Evaluation Of The Effectiveness Of Tax Incentives And Sanctions In Improving Tax Compliance Of Corporates In 2025

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Abstract

This study analyzes the impact of tax incentive and sanction policies on taxpayer compliance levels in Indonesia, as well as identifying their weaknesses and implementation gaps. The research employs a qualitative method using a literature review approach based on secondary data from academic journals and tax regulations. It examines the effectiveness of policy instruments such as tax holidays, tax allowances, and the exemption or reduction of final income tax for micro, small, and medium enterprises (MSMEs), as well as the implementation of administrative and criminal tax sanctions. The findings reveal that incentives can encourage voluntary compliance and expand the tax base if designed in a targeted manner; however, they are often hindered by moral hazard, weak monitoring, and misdirected targeting. Consistent and proportional sanctions can enhance both formal and material compliance, but their effectiveness decreases when law enforcement is uneven, public outreach is limited, or legal processes are overly lengthy. This study underscores the need for a combined policy approach integrating incentives and sanctions with tax education, administrative digitalization, governance transparency, and enhanced monitoring capacity to improve tax morale, narrow the compliance gap, and optimize sustainable state revenue.

Keywords : *tax compliance, tax incentives, tax sanctions.*

JEL Codes : H25, H26, H20

INTRODUCTION

Tax compliance, according to the definition provided by the IBFD International Tax Glossary, is a procedural and administrative action imposed on taxpayers to fulfill their obligations in accordance with the applicable tax regulations (Mardlo, 2023). Tax compliance refers to the ability and willingness of taxpayers to pay and report taxes accurately and on time, as well as to carry out their tax-related obligations in line with prevailing tax laws.

Tax compliance serves as an indicator in assessing the achievement of tax revenue targets in a country. The level of tax compliance is also a benchmark for evaluating the implementation of taxation and for assessing the effectiveness and efficiency of a country's tax system. Tax compliance is crucial because taxpayers, as the source of tax revenue, are directly linked to state income, which in turn affects the overall economic condition of a country. If taxpayers fail to adhere to the established tax rules, they tend to engage in practices that reduce tax revenues, such as tax avoidance, tax evasion, and tax fraud. These practices carry significant potential to cause losses to the state, making it essential for governments to ensure that taxpayers do not commit tax violations.

According to data published on the official website of the Directorate General of Taxes (DJP), the annual tax return (SPT) filing compliance ratio in 2018 reached 71.1 percent, which continued to increase to 73.06 percent in 2019, 77.63 percent in 2020, 84.07 percent in 2021, 86.8 percent in 2022, and 86.97 percent in 2023. However, in 2024, the tax compliance ratio declined to 85.75 percent.

Taxpayer compliance has a significant impact on a country's economy, particularly on state revenues and the tax system. In the context of state revenues, low compliance directly results in the failure to achieve tax revenue targets, which constitute the main source of income in the State Budget (APBN). When the amount of tax paid does not reflect the actual potential, the government tends to cover the budget shortfall through debt financing, which ultimately increases the fiscal burden and the risk of dependency on foreign

loans. Furthermore, the unequal tax burden between compliant and non-compliant taxpayers creates disparities and injustice within the tax system, which in turn may lower tax morale and voluntary compliance.

From the perspective of the tax system, low compliance increases the administrative burden for tax authorities in terms of supervision, auditing, and law enforcement. This not only requires substantial costs but also causes inefficiencies in the execution of the duties of the Directorate General of Taxes (DJP). Moreover, this phenomenon fosters the growth of the informal sector or shadow economy, which is difficult to monitor and contributes to widening the compliance gap.

The impact on the economy also cannot be overlooked. Limited tax revenues reduce the government's spending capacity, particularly in financing public services such as education, health, and infrastructure, which are crucial for supporting long-term economic growth. On the other hand, uncertainty and inefficiency in the tax system, as reflected in low compliance, also weaken investor confidence, both domestic and foreign. This imbalance creates market distortions, where non-compliant businesses can offer lower prices compared to compliant ones, resulting in unfair competition. Therefore, improving tax compliance has become an urgent matter, requiring a comprehensive approach that includes tax education, digitalization of tax administration, targeted incentives, as well as consistent and firm law enforcement.

To ensure that taxpayers comply with their tax obligations, the Directorate General of Taxes implements sanction rules for those who commit tax violations, as well as incentives to increase taxpayers' willingness to pay and report taxes.

LITERATURE REVIEW

Literature review is a state of the art of the research that is conducted, which contains concepts, theories that support the research, and previous research which become the main reference for the research. If the research conducts empirical tests, then this part also contains the mindset for the hypothesis.

Tax

According to the General Provisions and Tax Procedures Law (UU KUP), tax is defined as a mandatory contribution to the state owed by individuals or entities, which is coercive in nature under the law, without receiving direct compensation, and used for state purposes to achieve the greatest prosperity of the people (pajak.go.id).

Tax plays a fundamental role in the development and sustainability of a country, while also providing tangible benefits for all levels of society. For the state, tax functions as the main source of funding for various expenditures. This includes financing productive projects that generate economic returns, such as the agricultural sector, as well as reproductive expenditures that provide long-term benefits. In addition, taxes are also allocated for non-productive expenditures such as the construction of historical monuments, and for social and defense purposes, for instance funding orphanages or the military budget.

For society, the benefits of tax are directly felt in daily life. Tax funds are used to build and maintain vital infrastructure such as hospitals, roads, schools, and various other public facilities. Taxes also enable the government to provide subsidies for basic needs such as fuel and food, as well as to supply affordable public transportation services. Furthermore, taxes support the implementation of democratic processes, including financing general elections.

In Indonesia, the government focuses primarily on the two functions of tax: regulatory and budgetary. The government body that manages state taxation in Indonesia is the Directorate General of Taxes (DJP), under the Ministry of Finance. The responsibility for fulfilling tax obligations lies with the citizens themselves, in accordance with the self-assessment system adopted in Indonesia's tax system. Self-assessment means that taxpayers calculate, account for, deposit, and report their own tax obligations. Thus, taxpayers are not forced to pay as much tax as possible, but rather in accordance with the applicable laws and regulations.

Tax Compliance

Tax compliance is a procedural and administrative action imposed on taxpayers to fulfill their obligations in accordance with applicable tax regulations (Mardlo, 2023). Tax compliance is divided into two categories: administrative or formal compliance, and technical or material compliance (Asmarani, 2020). Administrative or formal tax compliance assesses the extent to which taxpayers adhere to procedural and administrative requirements of taxation, including reporting requirements, filing deadlines, submissions, and tax payments. Meanwhile, according to the OECD, technical or material tax compliance refers to the accurate calculation of the tax liability. Technical or material compliance reflects the condition in which taxpayers meet the substantive provisions of taxation, that is, in line with both the content and the spirit of tax laws.

There are four indicators used to assess tax compliance:

1. taxpayer compliance in registering as a taxpayer (WP),
2. taxpayer compliance in submitting the Annual Tax Return (SPT) on time,
3. taxpayer compliance in calculating and paying their tax liability, and
4. taxpayer compliance in paying tax arrears (STP/SKP) before the due date.

In general, several factors influence taxpayer behavior in relation to tax compliance. These factors include: deterrence efforts, which refer to the intensity of tax audits and the sanctions applied for tax violations; the norms or values upheld by taxpayers; the opportunity to comply with tax regulations or to commit violations; fairness, related to the enforcement of tax laws or the implementation of tax procedures; and economic factors, which include the taxpayer's general economic condition that will affect the amount of tax payable (Asmarani, 2020).

Tax Sanctions in Indonesia

Tax sanctions are penalties or consequences imposed on taxpayers for violations of applicable tax provisions and regulations. These sanctions function as a preventive measure to ensure that taxpayers do not breach tax norms and comply with their tax obligations in accordance with the law.

In general, tax sanctions are divided into two main categories: administrative tax sanctions and criminal tax sanctions. Administrative tax sanctions usually take the form of interest charged on late tax payments, fines for administrative violations such as late submission of the Annual Tax Return (SPT), and surcharges imposed in cases of underpayment or falsification of data. These sanctions serve to compensate the state for financial losses and act as a means to compel taxpayers to fulfill their tax obligations correctly and on time. For instance, the interest rate imposed is approximately 2% per month on overdue tax liabilities.

On the other hand, criminal tax sanctions are applied to more serious violations, such as tax evasion or other tax-related criminal offenses. These sanctions may take the form of criminal fines, detention, or imprisonment, with the length of the sentence determined by law. Thus, criminal sanctions represent a more severe legal measure used to enforce tax norms and create a deterrent effect against serious violations.

Tax Incentives in Indonesia

Tax incentives are penalties or consequences imposed on taxpayers for violations of applicable tax provisions and regulations. These incentives function as a preventive measure to ensure that taxpayers do not breach tax norms and comply with their tax obligations in accordance with the law.

RESEARCH METHOD

The research was conducted using a qualitative method with a literature review approach, employing secondary data from various scientific journals, articles, and tax-related laws and regulations. The analysis was carried out descriptively to interpret the available data and information in order to evaluate tax sanction and incentive policies in relation to the level of tax compliance in Indonesia.

RESULTS AND DISCUSSION

The Impact of Tax Incentives in Indonesia

Impact on State Revenue

Incentive policies, such as tax rate reductions, exemption of Final Income Tax (PPH Final) for Micro, Small, and Medium Enterprises (MSMEs), and the elimination of administrative sanctions, play an important role in encouraging increased voluntary tax compliance. This increase in compliance has a positive effect on tax revenues, particularly in the medium to long term, as it motivates taxpayers to actively fulfill their tax obligations without coercion. Moreover, incentives also hold strategic value in expanding the tax base, for example through tax amnesty policies that provide opportunities for taxpayers to declare previously unreported assets, or through the application of initial rate relaxations for new taxpayers who are in the process of building their businesses. Thus, incentives function not only as short-term stimuli but also as policy instruments that strengthen the foundation of sustainable tax revenues.

Impact on Taxpayer Compliance

Incentives encourage voluntary compliance by providing tangible rewards for compliant behavior, such as the application of lower tax rates, simplification of administrative procedures, or the elimination of sanctions within a certain period. Incentive policies that have been implemented, such as the sunset policy and tax amnesty, have proven effective in increasing tax reporting, encouraging taxpayers to declare assets, and improving the relationship between taxpayers and tax authorities. In addition, incentives also contribute to the enhancement of tax morale, namely the awareness and willingness to pay taxes voluntarily without coercion, which ultimately has a positive impact on taxpayer compliance levels in the long run.

Weaknesses in the Implementation of Tax Incentives in Indonesia

Tax Holiday

A tax holiday is a tax incentive policy that provides full or partial exemption from corporate income tax (CIT) for a certain period, which in Indonesia can last up to 20 years, particularly for pioneer industries or large-scale investments. The implementation of this policy is generally carried out through an application process by companies that meet certain criteria, such as the scale of investment, priority business sectors, and commitment to job creation. Approval is granted by the government following administrative and technical evaluations, and the incentive takes effect once the company begins commercial production.

Although intended to attract investment, tax holidays have weaknesses. Long-term tax exemptions may directly reduce state revenue, particularly in the early stages of investment. Furthermore, the policy does not always effectively attract new investors, as it sometimes merely provides additional benefits to those already planning to invest in Indonesia. Targeting inaccuracy is also an issue when the facility is granted to financially strong companies. In terms of implementation, the lack of post-approval monitoring allows companies to reduce their investment commitments after receiving approval. Risks of transfer pricing and profit shifting abroad may also reduce domestic economic benefits. In addition, the lack of transparency in the selection process creates opportunities for rent-seeking practices, ultimately diminishing the policy's effectiveness as an instrument for boosting investment and state revenue.

Tax Allowance

A tax allowance is a tax incentive granted in the form of a reduction in taxable income, usually in the form of investment cost deductions or reduced corporate income tax rates for companies in specific sectors or regions. In Indonesia, this policy is regulated by government regulations and is granted after companies meet administrative requirements and technical criteria such as investment size, number of employees, or contribution to regional development. The implementation process involves the taxpayer submitting an application to the government, an eligibility evaluation by the relevant authorities, and the granting of the incentive for a specified period in accordance with the regulations.

The application of tax allowances has several weaknesses and loopholes. Their effectiveness is low when granted to sectors that do not significantly contribute to Gross Domestic Product (GDP) or job creation. In some cases, companies that are already operating at a loss gain no benefit, as they do not have taxable profits to deduct. This limits the real impact on investment growth and state revenue, particularly if the incentives are not directed toward high-growth economic sectors.

In practice, tax allowances contain implementation gaps that can reduce their effectiveness. Complex technical criteria often pose barriers for many businesses, especially Micro, Small, and Medium Enterprises (MSMEs), to access this facility. In addition, there is potential for companies to manipulate financial statements in order to meet the requirements or inflate investment cost deductions, which ultimately reduces the accuracy of eligibility assessments and diminishes the policy's benefits for the economy.

Exemption or Reduction of Final Income Tax (PPH Final) for MSMEs

The exemption or reduction of Final Income Tax for MSMEs is a tax incentive policy that provides lower tax rates—such as from 1% to 0.5% of turnover—or even full exemption under certain conditions. In Indonesia, this policy is regulated by tax laws and aims to ease the tax burden while encouraging MSMEs to enter the formal tax system. Its implementation involves taxpayer registration (NPWP), monthly or annual turnover reporting, and the calculation of Final Income Tax based on the applicable rate. Eligible MSMEs may automatically obtain this preferential rate, while oversight is carried out by the Directorate General of Taxes through reporting and periodic audits.

The imposition of lower Final Income Tax rates does ease the fiscal burden of MSMEs but does not automatically increase formal compliance. This is because many MSME actors still lack a Taxpayer Identification Number (NPWP) or adequate tax awareness. Moreover, there is a potential for moral hazard, where larger businesses split their operations into smaller units to qualify as MSMEs and benefit from lower tax rates.

The implementation of this policy still faces several loopholes that reduce its effectiveness. Limited monitoring of turnover and business status often results in inaccurate or even manipulated turnover reports. Furthermore, the tax administration system for MSMEs, which is not yet fully integrated, complicates compliance verification, making it difficult to detect potential violations and ultimately reducing the policy's benefits in improving tax revenue and ensuring sustainable taxpayer compliance.

The Impact of Implementing Tax Sanctions

Impact on State Revenue

The application of administrative sanctions, such as fines for late submission of the Annual Tax Return (SPT) and interest on tax underpayments, is an important instrument to encourage taxpayers to fulfill their obligations on time in order to avoid additional costs. The effectiveness of sanctions as a tool for increasing tax revenue greatly depends on the consistency of law enforcement and the degree of legal certainty applied by the tax authorities. Consistent, transparent, and fair enforcement can reduce the potential tax gap and directly increase state revenue. However, sanctions that are imposed excessively or disproportionately may create negative effects, such as triggering tax resistance or encouraging some businesses to shift to the informal sector in order to avoid what they perceive as unfair tax burdens. Therefore, sanction policies must be designed proportionally, taking into account aspects of fairness, education, and guidance, so that they can function as an effective deterrent without reducing taxpayer trust and willingness to comply voluntarily.

Impact on Taxpayer Compliance

Sanctions that are clearly formulated and consistently enforced play an important role in improving taxpayers' formal compliance, which includes the timely filing of Annual Tax Returns (SPT) and tax payments. This is due to the financial risks and legal consequences faced by taxpayers if they fail to meet their tax obligations. Furthermore, effective sanction implementation can also promote material compliance, ensuring the accuracy and completeness of the data reported in the SPT, particularly when these sanctions are supported by adequate and continuous monitoring mechanisms. Thus, sanctions serve not only as a law enforcement tool but also as a means of controlling the quality of tax reporting.

Nevertheless, the effectiveness of sanctions is strongly influenced by the approach used. If sanctions are applied without sufficient education and outreach, they may create negative perceptions and reduce taxpayer trust in the tax authorities. In the long run, this condition can weaken voluntary compliance. Therefore, a strategy that integrates law enforcement with education, communication, and public understanding of the purpose and benefits of tax sanctions is essential.

Gaps in the Implementation of Tax Sanctions in Indonesia

Inconsistent law enforcement

Administrative and criminal tax sanctions are not always enforced uniformly, which reduces the deterrent effect and encourages the perception that tax violations can be avoided.

Lack of outreach and education

Many taxpayers do not fully understand sanction provisions due to limited outreach, leading to violations not only from intentional evasion but also from ignorance.

Sanctions are not always proportional

The amount of fines or interest is sometimes perceived as too high by taxpayers, triggering resistance or encouraging them to avoid the formal system.

Limited supervisory capacity

The limited number and capability of tax officials hinder optimal monitoring of compliance and enforcement of sanctions, particularly for taxpayers in remote areas or in the informal sector.

Lengthy and complex legal processes

The long resolution of tax disputes, including appeals or objections, reduces the immediacy of the deterrent effect of sanctions for taxpayers.

Low level of legal certainty

Differences in the interpretation of regulations between tax authorities and taxpayers create uncertainty, making the implementation of sanctions a frequent source of disputes.

CONCLUSION AND SUGGESTION

Taxes play a strategic role in ensuring the sustainability of state revenue and maintaining the stability of the taxation system. Improvements in taxpayer compliance can be achieved through a combination of incentive and sanction policies that are designed to be proportional, well-targeted, and supported by adequate education and outreach. Incentives, such as tax holidays, tax allowances, and the reduction or exemption of final income tax (PPH Final) for MSMEs, have proven effective in encouraging voluntary compliance and expanding the tax base, although their effectiveness is often hindered by weaknesses in policy design, implementation gaps, and the risk of misuse. On the other hand, tax sanctions are capable of improving both formal and material compliance if enforced consistently, transparently, and fairly; however, their effectiveness may be reduced if law enforcement is uneven, monitoring capacity is limited, or legal processes are excessively lengthy.

Therefore, efforts to enhance tax compliance require a comprehensive approach that integrates incentives encouraging voluntary participation with sanctions that function effectively as law enforcement tools. Improvements in governance, strengthened supervisory capacity, digitalization of administration, and transparency in determining recipients of tax facilities are needed to minimize moral hazard and inequity. In this way, tax policy serves not only as a fiscal instrument to secure state revenue but also as a means to create fairness, enhance tax morale, and promote sustainable economic growth.

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