



## Indonesia: Tax Revenue Administration Modernization and Policy Improvement in Local Governments

Project Name	Tax Revenue Administration Modernization and Policy Improvement in Local Governments	
Project Number	48294-001	
Country	Indonesia	
Project Status	Active	
Project Type / Modality of Assistance	Technical Assistance	
Source of Funding / Amount	<b>TA 8877-INO: Tax Revenue Administration Modernization and Policy Improvement in Local Governments</b>	
	Government of Switzerland	US\$ 5.00 million
Strategic Agendas	Inclusive economic growth	
Drivers of Change	Governance and capacity development Knowledge solutions Partnerships Private sector development	
Sector / Subsector	<b>Public sector management</b> - Public administration	
Gender Equity and Mainstreaming	No gender elements	

## Description

### a. Link to Country Partnership Strategy/Regional Cooperation Strategy:

The first Pillar of the Indonesia CPS (2012-2014) identifies achieving inclusive growth which is essential for alleviating poverty by strengthening local governments' capacity for public service delivery. The CPS also identifies the crosscutting public sector management initiatives to support national efforts to strengthen governance in an increasingly decentralized framework. The proposed Capacity Development Technical Assistance (TA) supports the central government's fiscal decentralization agenda. In particular, it supports the implementation of the central government's two main strategic documents: the Grand Strategy for Fiscal Decentralization (GSFD) and the National Action Plan for Fiscal Decentralization (NAPFD). This TA is also in line with, and will support, the ongoing implementation of the DGFB's medium-term Institutional Transformation Program. This TA will focus on reducing dependency on fiscal transfers for local development by developing more buoyant sources of local revenues. The key aspect will be strengthening the capacity of LGs in tax policy and revenue administration. Thus, the proposed TA is in line with the ADB Independent Evaluation Department's recommendation to support Indonesia local governments in financial asset management. This TA aims to support the Government of Indonesia (GoI) in strengthening local tax revenue administration and policy at the central and local levels.

At the central level, the TA will focus on improving the capacity of the Ministry of Finance's Directorate General of Fiscal Balance (DGFB) in overseeing the revenue assignment process from CG to LG to take place in a smooth and sustainable manner. The key activities will be on capacity building of Ministry of Finance's DG Fiscal Balance in overseeing fiscal decentralization, working with the government's tripartite team on Law No. 28 (DGFB, DG Tax of MOF, and MOHA), and conducting joint studies and preparing academic papers to review the effectiveness of the Law as well as its implementing regulation. The key effort will be working closely with DGFB on evaluating the impact and implications of Law No. 28/2009 on the intergovernmental transfer system, specifically looking at the incentive effects of the DAU on local revenue mobilization. Key activities in policy reform aim to produce policy recommendations, such as revised joint ministerial decree between MOF and MOHA on the transfer of land and building tax to LGs and policy recommendation to MOF on incentivizing LGs to better manage their owned-source revenues.

On the administrative aspects, the TA at the central level will focus on upgrading the knowledge of DGFB staff on good practices through field visits and a series of training/workshops on effective and efficient local revenue administration with key objectives to find cost-effective and politically acceptable solutions, and establish sustainable central support for an efficient and equitable revenue administration at small (Tier 3) local governments.

At the local level, the TA will focus on supporting the establishment of a modern, efficient, and credible revenue administration at selected LGs with objective to promote voluntary compliance. The focus of the TA at the local level is to build centers of excellence on revenue administration in selected strategic LGs, which later can further share knowledge, solutions, and lessons learned to other LGs. The key activities will include, but not limited to, conducting institutional assessment of existing revenue administration capabilities, estimating revenue gaps and potential, building capacity in revenue policy and management, assisting in the expansion of tax bases coverage and updating fiscal cadastre, improving current and in-arrears revenue performance, providing training in valuation of tax objects and information technology development, assisting in upgrading/developing the overall revenue administration systems, and supporting the project and change management. These activities are expected to provide sustainable implementation of a modern, taxpayer focused revenue policy and administration in LGs.

Even though cases found in selected LGs may not be same as those found in other LGs, the proposed policy and management solutions offered in the selected LGs will take into account the replicability to other LGs, taking into account the local administrative, political, and infrastructure conditions as well as the level of development of the other LGs.

#### Indicative Local Governments to be Engaged

MOF has already indicated their overall national strategy to increase the country's consolidated tax ratio from the current 12.5% of GDP to 19.0% of GDP over the next 7-8 years. DGFB team has informed ADB team of their plan to increase the local tax to GDP ratio from 1.4% in 2012 to 1.7% in 2015. The plan to increase the tax ratio will also be done simultaneously with the effort to increase the ratio of owned-source revenue to local budget from 16% in 2012 to 22-25% in 2015. With these in minds, the focus of the proposed TA will be on urban LGs that have already the potential to increase their revenue due to the size of its economy and its population.

Cities such as Jakarta, Bandung, Medan, Semarang, Badung (Bali), Balikpapan or Makassar are the potential candidates. These LGs have shown strong potential for improving sustainable local revenue mobilization, which can be leveraged into long-term capital investment for improved local infrastructure and services.

In addition to urban LGs, the proposed TA will work with a selected number of LGs that are weak in their capacity but have the potential to increase their revenue due to increase in economic activity. Such potential LGs can be drawn from Eastern part of Indonesia that has been indicated to be center of economies, such as City of Ambon or Sorong in Papua. Overall, the selection of LGs depends on the commitment from local leaders, local revenue improvement potentials, investment cost sharing capacity, and logistical complexity, along with discussion with the DGFB.

#### Synergy with ADB Ongoing Support

The proposed TA activity, in line with ADB decentralization program in Indonesia, complements the on-going ADB programs in the public finance management as the State Accountability Revitalization (STAR) Project, and also ADB's program-based series of Local Government Finance and Governance Reform Program (LGFR). The proposed TA is a scale up of the on-going TA-8057 (INO): LGFR. The ADB TA-8057 has been supporting DGFB and five selected LGs in the property tax devolution through providing technical assistance and capacity building in improving the property tax payment system, debt management, fiscal cadastre maintenance, property valuation, and information systems development. In May 2014, the TA-8057 completed a preliminary institutional diagnostic of the revenue administration of DKI Jakarta. The diagnostic analyzed gaps in existing organization structure, human resource management, and information technology capabilities, as well as in potential revenues of the major tax types, including property tax, property transfer tax, advertisement tax, vehicle tax, and hotel/restaurant/entertainment taxes. The proposed TA activity is the logical continuation of the ongoing ADB support to strengthen governance in LGs, particularly in the area of local revenue administration where no other developing partner is providing direct support to LGs.

Project Rationale and Linkage to Country/Regional Strategy

The institutional design for Indonesia's 'big bang' decentralization, which began in 2000, largely rests on three interrelated and mutually reinforcing pillars: (i) autonomy of action, (ii) accountability for responsive performance, and (iii) capacity to perform the functions. The autonomy of action is largely determined by an LG's charter that defines its powers through the higher level of government. Accountability is determined by the nature of relations between the LG and Central Government (CG) (upward accountability), the relations between the LG and the local council (internal horizontal accountability), and the voice of the citizens in demanding the functioning and performance of their district or city (downward accountability). The capacity of an LG is determined by its management and operational structure.

Decentralization has increasingly afforded sub-national governments the autonomy to manage their own fiscal affairs. The design of local revenue systems includes (i) the level of autonomy that local governments can exercise in setting revenue policy and raising own-source revenues, and (ii) the efficiency of the revenue administration system. The passing of Law No. 28/2009 on Local Government Taxes and Retributions provides more autonomy to LGs in raising own-source revenues, or PAD, in particular by expanding LG tax and user fee (retribusi) bases while giving LGs the discretion to set up their own tax and fee rates. The Law is very specific with regards to the revenue assignment and taxation power of provincial governments (Level 1 LGs) and municipal or district governments (Level 2 LGs), with more power given to Level 2 LGs. Notably, Law No. 28/2009 devolves land tax (for buildings and property) so that, effective 1 January 2014, it is administered completely by LGs.

The impact on the ground has been significant. Own-source revenues, as a share of total budget resources, have been significantly increasing from 18.6% in 2010 to 19.66% in 2011 to 20.4% in 2012. However, these increases have not been accompanied by an increase in local tax ratios or local tax per capita, which in 2012 stood at approximately 1.4% of GDP and close to Rp. 77,000, respectively. In fact, the average local tax ratio in 2012 (1.4% of GDP) was significantly lower as compared to 2011 (2.9% of GDP).

With increased fiscal autonomy, LGs can be expected to exhibit increased accountability to their constituents in raising and administering local revenues. Recent research supports the view that taxation policy and administration are critical for improving governance. Taxation forms the basis of accountability relationships \_ based on mutual rights and obligations \_ between the local government and its constituents. Constituents that pay taxes have a right to demand accountability, and LG expenditure must be responsive to the needs and preferences of citizens. The emergence of a more accountable local government occurs when the LG faces incentives to increase its public budget through engagement with constituents rather than through reliance upon central government transfers and/or narrow natural resource rents. Property tax is an excellent example of a tax that promotes public participation and greater LG accountability given that it is direct, highly visible, substantial and affects a large proportion of the constituency.

However, lack of capacity at the local level makes it difficult for LG to properly develop local tax policies and administer their local taxes. Thus, as LGs are given more responsibilities in managing their own fiscal affairs, there is a pressing need to significantly and rapidly increase the technical, administrative, and fiscal policy analysis and revenue mobilization capacity of local public financial officers, especially in light of the enormous revenue potential. LG financial officers currently have limited capacity in analyzing the local revenue potentials and implementing effective revenue administration, particularly with regards to the recently devolved property tax. Inappropriate tax policy and/or ineffective administration lead to low voluntary compliance and low revenue yields. Low voluntary compliance is exacerbated by local tax regulations that impose a heavy burden or high compliance costs and contributes to low revenue yields. Low revenue yields affect public service delivery, weaken downward accountability, create opportunities for rent-seeking activities and increase reliance on central government transfers. The introduction of e-tax services (electronic registration, filing, payment, and other inquiries) being proposed under this TA will reduce direct contacts between taxpayers and tax officials, and thus will strengthen governance, faster responses, and lower compliance costs.

Impact	Increases in own-source revenues, tax compliance rates and local tax ratios.
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## Project Outcome

Description of Outcome	Improved tax administration and policymaking capacity of selected LGs.
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Progress Toward Outcome

### Implementation Progress

Description of Project Outputs	<ol style="list-style-type: none"> <li>1. Harmonization and delineation of responsibilities between CG and LG on tax policy and administration</li> <li>2. Institutional transformation of local revenue administration</li> <li>3. Revenue administration systems development and implementation</li> <li>4. Broadening of tax bases through updating fiscal cadastre</li> </ol>
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Status of Implementation Progress (Outputs, Activities, and Issues)

Geographical Location

## Summary of Environmental and Social Aspects

Environmental Aspects

Involuntary Resettlement

Indigenous Peoples

## Stakeholder Communication, Participation, and Consultation

During Project Design

During Project Implementation

## Business Opportunities

Consulting Services The TA plans to engage 324 person-months of consulting services (68 international pm and 256 national pm) through a mix of individuals and a firm. Selection of the firm will use a quality cost-based selection at a ratio of 80:20 and a full technical proposal. All consultants will be recruited in accordance with the ADB Guidelines on the Use of Consultants (2013, as amended from time to time). The proposed TA will carry out an Advance Procurement Action to expedite the recruitment of consultants prior to TA effectiveness.

## Responsible Staff

Responsible ADB Officer	Hattari, Rabin I.
Responsible ADB Department	Southeast Asia Department
Responsible ADB Division	Indonesia Resident Mission
Executing Agencies	<i>Directorate General Fiscal Balance Jalan Lapangan Banteng Timur 2-4 Jakarta Pusat 10710 Indonesia</i>

## Timetable

Concept Clearance	30 Sep 2014
Fact Finding	02 Oct 2014 to 09 Oct 2014
MRM	-
Approval	12 Feb 2015
Last Review Mission	-
Last PDS Update	30 Mar 2017

## TA 8877-INO

Milestones					
Approval	Signing Date	Effectivity Date	Closing		
			Original	Revised	Actual
12 Feb 2015	17 Mar 2015	17 Mar 2015	28 Feb 2018	31 Dec 2018	-

Financing Plan/TA Utilization						Cumulative Disbursements		
ADB	Cofinancing	Counterpart				Total	Date	Amount
		Gov	Beneficiaries	Project Sponsor	Others			
0.00	5,000,000.00	250,000.00	0.00	0.00	0.00	5,250,000.00	12 Feb 2015	995,312.56

Project Page <https://www.adb.org/projects/48294-001/main>

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