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Exit Tax Adoption to Protect Indonesia's Tax Base: Are We Ready?

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ABSTRACT

The mobility of individuals, assets, and businesses across international borders is common. This dynamic shift in residency and business structure can lead to significant capital gains, posing tax revenue challenges for nations like Indonesia. The departure of High Net Worth Individuals (HNWI) has brought this issue to the forefront. To address revenue loss due to tax avoidance of that mobility, many countries have adopted exit taxes or exit charges. These measures impose income tax when individuals or businesses change tax residency or transfer assets across borders. This paper conducts a qualitative analysis to explore the adoption of exit taxes in Indonesia, offering policy recommendations to integrate exit taxes into Indonesia's existing tax framework. This paper discusses the idea of exit charge adoption in Indonesia through a qualitative analysis by reference to a comparative study of tax law in various jurisdictions. The study shows that the exit charge adoption is feasible to undertake, considering the existing legal system, Indonesia's tax regulation, and the simplicity aspect of the taxation system, which Indonesia aims to enhance.

Keywords: exit charge, exit tax, change of tax residency, business restructuring

1. INTRODUCTION

The world economy has come to an era where companies and individuals can move across jurisdiction borders and seek new advantageous opportunities and business options in other countries. This has resulted in the change of residency and assets shifting through a business restructuring. The adverse of such migration is tax revenue loss of capital gains that occurs when the shifted assets are sold in the country where the residence is changed (Beer et al., 2018). This issue is particularly relevant for Indonesia, which finds itself among the top 10 countries witnessing a considerable outflow of High Net Worth Individuals (HNWI) according to The Henley Global Citizens Report (2022), with an estimated 600 individuals leaving the country.

Business restructuring, a common practice in today's global economy, is not inherently a tax avoidance strategy. Nevertheless, the potential for tax-driven motives in such restructuring events must be considered, given the significant tax implications that businesses face. Global business restructuring often involves the transfer of crucial functions, risks, or highly profitable intangible assets to overseas locations, resulting in income shifting and a misalignment between value creation and taxable jurisdiction. This mismatch

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can enable multinational companies to reduce their overall corporate tax burden post-restructuring, as Tsuji (2020) highlighted.

In response to the threat of revenue forgone caused by tax avoidance, many countries have adopted exit tax or exit charge, which is an income tax paid by an individual or business company when the person shifts his/her residence from one State to another or when a cross-border transfer of an entity's assets occurred (Kubicova, 2016). The exit tax is commonly levied on the value of unrealized capital gain on the disposal of assets, which is generally deemed to happen after the residence status is renounced or after the transaction of transferring a business or asset takes place.

The policy rationale of charging an exit tax as an anti-avoidance measure has been supported by numerous studies on the effectiveness of existing anti-avoidance measures and the drawbacks of tax avoidance on tax revenue collection. For the most recent years, a one percentage point lower corporate tax rate compared to other countries will expand before-tax income by 1,5 percent (Beer et al., 2018). The result is higher than the previous study conducted by Heckemeyer et al. (2017), which suggested semi-elasticity of as much as 0,8 percent. Such a study indicates that the existing anti-avoidance measures have not yet been sufficient to address the tax avoidance issue.

Despite the debatable view towards its fairness and complication issues, exit tax has been adopted by many countries. The primary purpose of the adoption is to prevent speculative, tax-motivated transfers of tax residency. Its proponents consider that the application of exit tax is of the horizontal tax fairness between residents who stay and those who leave their home country for good since both will pay capital gain tax eventually and that the jurisdictions of which the tax residence is renounced substantially own the nexus for taxing the capital gain arising from asset disposal of the taxpayer (Kubicova, 2016). On the contrary, some oppose the idea of exit charges due to the double taxation issue that may arise.

This paper aims to offer a comprehensive analysis of the viability and desirability of implementing exit taxation in Indonesia. The authors will present a qualitative study concerning exit tax/exit charge implementation by adopting comparative studies of the tax law of jurisdictions that have adopted exit tax within their taxation landscape. Finally, the authors will propose policy recommendations for adopting exit tax on changes in tax residency and business restructuring in the Indonesian legal system. The term "exit tax" used in this paper is interchangeable with the term "exit charge", considering jurisdictions' best practices, scholars, and the applicability in the Indonesian tax system.

2. THEORETICAL FRAMEWORK

Following De Man et al. (2011), it is essential to make recourse to the scheme by Carvalho (2008) that is commonly used to demonstrate the features of particular taxes and to illustrate the nexus between the facts and their legal consequences when a tax is constructed.

$$\boldsymbol{Tn}\left[\begin{array}{l} \boldsymbol{Fs}\equiv \boldsymbol{Mc}(\boldsymbol{v}\cdot \boldsymbol{c})\cdot\ \boldsymbol{Sc}\cdot \boldsymbol{Tp} \\ \quad\Downarrow \qquad\qquad\quad \Leftrightarrow \\ \boldsymbol{Tc}\equiv \boldsymbol{Pc}(\boldsymbol{As}\cdot \boldsymbol{Ps})\cdot \boldsymbol{Qc}(\boldsymbol{Tb}\cdot \boldsymbol{Tr}) \end{array}\right.$$

Figure 1 The Notion of Tax Scheme
Source: Carvalho (2008) in De Man, et.al (2011)

$\equiv$ is the mathematical sign of equivalence**.**
$\downarrow$ is the mathematical vector to ascertain that if Fs happens, then Tc should also happen.
$\leftrightarrow$ is the mathematical vector that represents that someone has the legal obligation to pay a certain amount while another has the legal right to demand the payment.

Tn = Tax norm
Fs = Fattispecie, description of a fact
Mc = Material criterion,
Sc = Spatial criterion
Tp = Time period
V = Verb
C = Complement
Tc = Tax consequence

Pc = Personal criteria
As = Active subject, who can demand payment
Ps = Passive subject, who is obliged to pay the due amount
Qc = Quantifying criteria
Tb = Tax base
Tr = Tax rate

The tax norm comprises a Fattispecie (Fc), a description of a fact that will generate legal tax consequences (Tc). A fact is described by material facts (Mc) reflected by the verb (v) and the complement (c) made in a particular place (Sc) at a specific time (Tp). A legal consequence (the Tc) will arise as a result of the fusion between material, spatial, and time variables previously regulated, where the State (As) demands payment from a person (Ps) a certain sum of money established according to the tax base (Tb) and the tax rate (Tr), previously set down by the legislator.

Regarding the exit tax, according to the IBFD International Tax Glossary, the term exit taxes presuppose a cross-border element as the emigration of companies or individuals or a cross-border transaction (Hug, 2015). States often impose exit taxes to ensure that an amount of previously untaxed income, such as unrealized gains, which are attributable to their jurisdictions, is taxed before the taxation right is restricted or lost due to international tax law (Schuch & Pinetz, 2014). In the context of the business restructuring of a multinational enterprise, an exit charge generally refers to a payment made to compensate for the removal of an asset belonging to an entity whose activity in the business is being simplified or reduced (Henshall et al., 2012).

3. RESEARCH METHODOLOGY

This contribution is conducted under the framework of legal research. A comparative study of tax law in various jurisdictions is presented through qualitative analysis to construct a design of law regimes to apply in Indonesia.

Qualitative research commences by establishing initial assumptions and employing interpretive or theoretical frameworks to guide the investigation of research issues related to the significance that individuals or groups attribute to social or human problems (Creswell & Poth, 2017).

The authors then use a comparative legal study, which facilitates choice between legal systems (Bhat, 2015). When one tries to improve one's legal system, be it as a legislator or as a scholar, it has become apparent to look at the other side of the borders (Van Hoecke, 2015). Further, Wilson in McConville & Chui (2017) mentioned that the purpose of the study of comparative law is to make a practical contribution to the local national system.

To exercise the analysis, a literature review, defined as a written document presenting a logically argued case founded on a comprehensive understanding of the current State of knowledge about the topic of study (Machi & McEvoy, 2012), is employed as the tool.

After identifying the research problem and question, the authors will first describe the exit tax features in various jurisdictions with exit tax regimes in their tax systems. The exit tax profiles of countries are obtained by performing a literature review of relevant countries' legislations or law scholar articles. International documents provided by the Organisation for Economic Co-operation and Development (OECD), such as the OECD Model Tax Convention (MTC) and OECD Transfer Pricing Guidelines (TPG), also play a role as an international reference in this study. Henceforth, an in-depth comparative analysis is conducted to answer the research question.

4. RESULTS AND DISCUSSION

4.1 Exit Tax on the Change of Tax Residency

Indonesia's income tax system prescribes the taxation of a person, comprising individual and business entities, based on their residency status. As most countries around the globe do, Indonesia applies worldwide taxation to its resident taxpayers. In essence, the migration of an Indonesian tax resident would give two tax consequences for either departure or immigration states. While the tax base of the latter would broaden, the former would lose its right to tax on the income earned by its taxpayer. In that sense,

when a taxpayer resident of Indonesia moves to another country, he/she will give up their Indonesian tax residency. As such, Indonesia would not have a nexus to levy taxes after becoming a resident of another jurisdiction.

Further, tax motive is sometimes embedded within the cross-border movement of residency. Even worse, there is also tax avoidance risk associated with this event. One can migrate from a high-tax jurisdiction to a lower-tax jurisdiction and subsequently change taxpayer residency for tax purposes. OECD is of the view that exit or departure tax rules may prevent the avoidance of capital gains tax through a change of residence before the realization of a treaty-exempt capital gain (Paragraph 69 Commentary on Article 1 OECD Model Tax Convention 2017).

The nature of exit tax on the change of tax residency could be drawn with a notion on figure 2.

According to De Man et al. (2011), the material fact (Mc) of the exit tax is described by the verb (v) to leave and the complement (c) the State. The spatial criterion (Sc) is the jurisdiction of the emigration State, and then the Fiscal year is the time period (Tp). Regarding the tax consequence (Tc), personal criteria (Pc) consists of the emigration state (As) as an active subject imposing a tax on the passive subject (Ps), the emigrating person. The tax base (Tb) of the exit tax on migration is the unrealized capital gain.

Taking consideration best practices from other countries, the authors extracted several vital elements in crafting the exit charge regime within income tax regulation in Indonesia:

4.1.1 Person Covered

A person, both individual and company, might be subject to the exit charge only for certain conditions that are attached to them. This means that limitations are needed to impose exit charges due to the significance of the purpose. Canadian departure tax, for instance, limits the imposition to a resident based on the length of the residency period. Subparagraph 128.1(4)(b)(iv) Canadian ITA stipulates that it excludes a short-term residency, not more than five years' residency, during the ten years preceding emigration (Yager et al., 2002). This residency period is also applied by Australia pertaining to Capital Gain Tax[1] for an individual migration (Burns, 2002). The United States (U.S.) expatriation tax regime also excludes short-term residency, which applies to more than eight years of permanent residency of the 15 taxable years. Additionally, one of three factors should also be met by an individual expatriating: (1) Annual income tax, (2) net worth, and (3) legal compliance (Kwong, 2009).

Considering best practices by countries, to the authors' mind, the approach taken by the U.S. covering both material and formal compliance is essential in determining the personal scope of the Indonesian exit charge. Thus, the authors propose establishing the personal scope of exit charge with Compliance Risk Management (CRM) assistance. The risk-based assessment provided by CRM will reflect the taxpayer's formal and material compliance. Moreover, in cases where more considerations are needed, based on broader economic or policy purposes, CRM can facilitate this purpose by articulating its compliance variables.

$$\boldsymbol{Tn}\left[\begin{array}{c}\boldsymbol{Fs \equiv To\ leave\ a\ State(leave \cdot State) \cdot Jurisdiction\ of\ Emigration\ State \cdot Fiscal\ Year} \\ \Downarrow \qquad\qquad \Leftrightarrow \\ \boldsymbol{Tc \equiv Pc(State \cdot Emigrating\ person) \cdot Qc(Unrealized\ capital\ gain \cdot Tr)}\end{array}\right.$$

Figure 2 The Notion of Exit Tax on the Change of Residency
Source: De Man et al. (2011)

[1] Hereinafter referred as Australian Exit Tax

4.1.2 Material Scope

In essence, countries imposed the exit charge for all assets owned by a covered person with certain exceptions. Canada and the U.S. exclude assets remaining in the State's tax base (Chand, 2013). In addition, the U.S. exit tax includes the exemption amount of the gains, which amounted to $600,000. Meanwhile, the Australian exit tax covers capital gain from all assets with three exceptions: (1) assets that have the inextricable link with the Australian tax base, (2) assets of a short-term resident, (3) assets subject to Capital Gain Tax, i.e., non-inventory assets (Burns, 2002). However, this is debatable because certain businesses, such as share traders, could dodge the exit tax since share is regarded as a business inventory. Another jurisdiction, the Netherlands, has an exit tax applicable to substantial shareholdings.

To the extent of Indonesia's exit tax, the authors propose excluding assets that remain under the Indonesian tax base. This will include immovable property and/or assets recorded in the Permanent Establishment's statement of the financial position, given that the gain derived by the assets in question is taxable in Indonesia. Concerning the former, income arising from an immovable property situated in Indonesia, even though owned by a non-resident taxpayer, will still be taxable in Indonesia under Article 26 Income Tax Law (ITL), as the taxing right is allocated by Article 6, both UN and OECD MTC as well as adopted by Indonesian tax treaties with other States.

4.1.3 Mark-to-Market Regime

The exit charge works with the principle of deemed realization on the gain derived by assets at the moment when the taxpayer is about to cease their tax residency. This means that the taxable amount of the gain is determined on an unrealized basis. Similar to mark-to-market tax in the U.S., this regime allows Indonesia to levy an exit charge that would have been due had its former residents alienated their assets.

In that regard, a follow-up question is: how do we determine the fair market value of the assets at that point in time? Referring to a term used in transfer pricing, "arm's length principle", might assist in answering this riddle. This principle is widely used by OECD and EU countries (Pellecchia, 2018).[2]

The point of time of the value of the assets would be reasonable if set up on the last day of his Indonesian residency. From the authors' view, DGT already has the resources to assess the asset valuation: The Appraiser Officer. The valuation for tax purposes has been implemented since 2015 with DGT Circular Letter No: SE- 61/PJ/2015, which later is revised by SE-05/PJ/2020. In the later decree, The Appraiser Officer is also given a role in assessing the fair market price of asset transactions, the fair market value of shares, and calculating the value of net assets in tax amnesty. To that end, the authors propose the extension of the role of The Appraiser Officer in exit taxation by assessing the fair market value of the exit tax assets.

4.1.4 Type and Scheme of Exit Tax

One could argue that the exit tax cannot be imposed on Indonesian citizens because they have become non-residents and have no income from Indonesia. However, this argument is wholly rejected because the exit tax liability is established when a taxpayer is still an Indonesian resident on an income in the form of unrealized gain arises in Indonesia. The capital gains are deemed to have been made while he was a resident of Indonesia and not after he became a resident of the immigration State.

It is important to note that the material notion of exit tax depicts a taxable event when a person leaves the emigration State. Hence, the authors propose to opt-in for an immediate exit tax type because the notion means that the immediate exit tax type is considered the general exit tax. An option of deferral payment until the realization of the sale of an asset should be made available for a migrated taxpayer, as most exit tax regimes typically incorporate this feature. However, any

[2] See Recital no. 10 of the preamble to the ATAD (2016/1164)

value changes that occur, either gain or loss, in the post-emigration period should not be considered because otherwise, it would not fall under the exit tax scope (De Man et al.,2011).

The exit charge scheme must reflect the fair market value of the asset at the moment of emigration; thus, the deferral option should only play a role as a payment postponer of the established tax liability. This 'frozen' moment of exit tax[3], which could be convenient for the taxpayer's cash flow because it would be levied when the taxpayer sold the assets later. On the other hand, Indonesia can maintain its taxing right for the portion of gain accrued therein. There could also be a discussion on whether taxing unrealized gains in immediate exit charges contradicts the realization principle of the income tax adopted by the Indonesian tax system. From the authors' perspective, the justification for using unrealized gains is that Indonesia has already applied a similar regime in taxing gain on the revaluation of an asset stipulated in Article 4(1) ITL. On top of that, Indonesia's income tax adopts the Schanz-Haig-Simons concept of income, which defines income as an increase in wealth plus economic consumption (Holmes, 2001); thus, unrealized capital gains will be viewed as income (De Man et al., 2011).

In combination with the gain on deemed disposal of an asset, the authors propose the inclusion of gain of exit charge as a part of annual income tax since the capital gain is part of income subject to tax under Article 4(1) ITL. To calculate the income tax due, ITL prescribes that capital gains are considered ordinary income and subject to income tax. All expenses incurred in obtaining, billing, or maintaining capital gains are generally deductible (Kristanto, 2022). Henceforth, the immediate exit tax could be calculated with the annual income tax during the fiscal year. The question is, why do the authors not propose a final tax scheme? The justification for including the exit tax in an ordinary annual income tax would also relate to the elimination of double taxation, which will be discussed further in section 4.4.

4.2 Exit Charge on Business Restructuring Sub-section

Corporate restructuring or business restructuring is a set of discrete decisive measures to increase the competitiveness of a business entity and enhance its value. Corporate restructuring also entails an improvement in operational or financing structure to transform a firm into one that is of higher value or to survive when a corporate's business structure is indicated to be dysfunctional (Crum et al., 1998).

Applying an exit tax on business restructuring has been under the spotlight for years, as anti-avoidance motives are predicted to be embedded within a business restructuring event. Business restructuring could cause income transfer overseas and a mismatch between the place of value creation and the taxed place, resulting in a substantial reduction of the total corporate tax burden after the restructuring (Tsuji, 2020).

The authors prescribe the notion of exit tax on business restructuring using the notion of a tax scheme set out by Carvalho (2008) in De Man et al. (2011) on figure 3.

Exit tax on business restructuring, in essence, describes the fattispecie by the material criterion (Mc) containing restructure (v) of business (c). The spatial and time period criteria are in the jurisdiction of the foregoing entity in business

$$\boldsymbol{Tn}\begin{bmatrix} \boldsymbol{Fs \equiv Business\ Restructuring(Restructure \cdot Business)} \\ \boldsymbol{\cdot Jurisdiction\ of\ the\ Foregoing\ Entity \cdot Fiscal\ Year} \\ \Downarrow \qquad\qquad \Leftrightarrow \\ \boldsymbol{Tc \equiv Pc(State \cdot Foregoing\ Entity) \cdot Qc(Fair\ Market\ Value\ on\ Disposal\ of\ Assets \cdot Tr)} \end{bmatrix}$$

Figure 3 The Notion of Exit Tax on Business Restructuring
Source: the authors

[3] This term is used by De Man et al. (2011) to describe the deferred exit tax.

restructuring (Sc) and fiscal year, respectively. The tax consequence will depend on the triggering events. Based on triggering events that do not trigger the change of tax residency[4], the personal criteria (Pc) is derived by the State of the foregoing entity, as the active subject imposes a tax on the passive subject, the foregoing entity (Ps), in accordance with the quantifying criteria (Qc). The tax base (Tb) is the fair market value of the disposal of the assets due to a business restructuring. The notion was not the case when the triggering event resulted in the change of tax residency since the whole notion would be referred to as the notion described in Figure 2.

In practice, the operation of exit tax on business restructuring is undertaken through the application of transfer pricing principles and rules, as it involves the analysis of restructuring from independent entities' viewpoint – which would enter transaction according to sane business reasoning and not tax avoidance arrangement - to determine whether there are causes that could trigger the exit tax provision to apply legally.

4.2.1 Business Restructuring in Transfer Pricing's Perspective

Assessing how independent parties would undertake business restructuring is necessary since in the transaction between unrelated parties, the transfers that occurred might lead to a payment in recompense, which in substance is similar to an exit charge.

There are at least three aspects to analyze whether compensation would have been expected in transactions between independent parties, which are reallocation of profit potential – also called the "expected future profit", transfer of something of value, and termination of existing agreements (OECD, 2022a). An exit charge would generally be triggered if one of these is involved in a business restructuring.

First, if profit potential is reallocated, compensation to the entity forgoing such potential in the form of transferred functions or risks might be expected in the context of sane business logic. Such reallocation often occurs when an entity's functional assets and risk profile are altered. For example, if a fully-fledged distributor is restructured to be a limited-risk distributor or a sales agent of an overseas principal.

Nevertheless, the mere transformation of an entity's risk profile does not necessarily mean a warrant for a compensation payment. Instead, the tax authority should analyze and compare the historical performance of pre-restructuring and the projected business performance post-restructuring. A compensation payment would only be considered at arm's length if the analysis, as mentioned earlier, according to valid evidence, facts, and circumstances, concluded that actual potential profit had been reallocated. Besides, tax authorities must include an assessment called the "options realistically available" factor. The restructuring would only be considered at arm's length if no commercially more beneficial opportunities were available to meet the entity's objectives.

Secondly, another component in a business restructuring event upon which an exit charge might be a consequence is a transfer of "something of value", which includes tangible assets, intangible assets or the rights to such assets, and business activities, known as "ongoing concern". Transfer of an ongoing concern herein constitutes a transfer of functioning, economically integrated business unit. According to the OECD, this means the transfer of assets, bundled with the ability to perform certain functions, and assume certain risks (OECD, 2022b), which might consist of tangible and intangible property, liabilities associated with holding certain assets and performing certain functions such as R&D or manufacturing.

The third is the termination of existing agreements. If agreements are terminated or renegotiated to the detriment of the restructured party, it must be assessed whether an indemnification needs to be paid to ensure arm's length conditions (Gubelmann, 2021). In the case of terminations or renegotiations of arrangements, changes in the risk and functional profiles of the

[4] See Triggering events proposed by the authors in Section 4.2.3.3

parties generally occur, which brings consequences for the allocation of profit potential between parties. In addition, the termination or renegotiation of contractual relationships in the context of a business restructuring might cause the restructured entity to suffer detriments such as restructuring costs (e.g., write-off of assets, termination of employment contracts), re-conversion costs (e.g., in order to adapt its existing operation to other customer needs), and/or a loss of profit potential (OECD, 2022c). In these situations, the question of whether indemnification should be paid to the restructured entity (and, if so, how to determine such an indemnification) arose.

Notably, there should be no presumption that all contract terminations or substantial renegotiations should give a right to indemnification at arm's length. Instead, this will depend on the facts and circumstances of each case. In order to determine whether, at arm's length, the restructuring itself would give rise to a form of compensation, it is essential to understand the restructuring, including the changes that have taken place, how they have affected the functional analysis of the parties, what the business reasons for and the anticipated benefits from the restructuring were, and what options would have been realistically available to the parties.

4.2.2 Triggers of an Exit Tax on Business Restructuring

In general, regulations concerning exit tax on business or corporate restructuring adopt the transfer pricing principles. As elaborated in the sub-chapter 4.2.1, the trigger of exit tax implication involves these three aspects within a business restructuring: expected future profit, transfer of something of value, and termination of the existing arrangement. Hence, the triggers of an exit tax in numerous jurisdictions are designed by reference to those aspects, considering jurisdiction-specific considerations and interests.

The triggering event of an exit tax on a business restructuring is essential to draw, as it would limit the application of exit tax, which provides certainty on the coverage of the provision under a transaction-by-transaction basis. This means that only business restructurings that involve one of the triggers will be imposed by an exit charge. According to Chua (2022), the general triggers of exit tax on business restructuring are:

1. a transfer of the whole business from one jurisdiction to another; relocation of employees across the organization;
2. relocation of an asset, such as tangible assets, IP, agreements or clientele;
3. transfer of activity through termination or substantial renegotiation of existing arrangements.

In addition, besides the general triggers above, jurisdictions also set out events that could trigger exit tax within their taxation landscape, which considers their jurisdiction-specific policy rationale. Some of the jurisdictions' practices in terms of exit tax triggers are shown on table 1.

4.2.3 Envisioning Exit Charge on Business Restructuring Adoption in Indonesia

This paper discusses the fundamental principles of tax implications on business restructuring and international best practices of jurisdictions setting out their exit tax regime. In this subchapter, the authors boil down the ideas of applying an exit charge regime and feasible policy recommendations on business restructuring to implement within Indonesia's taxation landscape.

4.2.3.1 Legal Provision

First, since exit charge implication on business restructuring, in general, heavily adopts transfer pricing principles, authors propose that the triggering event of exit charge on business restructuring is conducted under the existing law in Indonesia; thus, no amendment of the law would be needed.

The obligation to comply with arm's length principles (i.e., the principles of independent parties that would drive their behavior and decision pursuant to a transaction with an unrelated party) is stipulated in Article 18(3) of the ITL and Ministry of Finance Regulation Number 22

Table 1 Comparison of Triggers of Exit Tax on Business Restructuring in the European Union
Source: Resumed by Authors

No	Jurisdictions	Jurisdiction-Specific Provisions Concerning Exit Tax Trigger	Elaboration
1.	Denmark	- Transfers of assets: only applied where the assets remain within the same company and not where assets are transferred to another company. - Transfers of tax residence. - Business transfers are carried on by permanent establishment from an EU member state to another member state or a third country.	A company will not be subject to exit taxation if the transfer of assets is of a temporary nature. Hence, assets set to revert to Denmark within 12 months are not comprised of the new rules on exit taxation.
2.	France	Transfer of self-developed intangible asset	Conversion from a distributor to a commission agent constitutes a formal transfer of clientele, which then triggers a potential capital gain and the applicable tax to the value of the clientele transferred.
3.	Germany	The change of business form before and after restructuring.	Compensation should be applied upon the termination of a commercial agent, commissionaires, and buy-sell distributors (if specific requirements are met).
4.	Switzerland	- A shift of the place of effective management of a Swiss company to abroad. - Transfer of assets from a permanent establishment to a company tax resident in another country or to a non-Swiss permanent establishment.	- No exit tax will apply if the tax basis is maintained in Switzerland. - If the registered office of an entity remains in Switzerland and no tax treaty applies covering the residency, the effective management office will be deemed to stay in Switzerland.
5.	United Kingdom	- Transfer of company tax residence status out of the jurisdiction. - Transfer of assets out of the jurisdiction. - The cessation of a trade carried out in the United Kingdom through a permanent establishment.	Exemption and relief on exit tax are available under the participation exemption regime.

of 2020. Article 18(4) of the ITL stipulates the definition of the related party.

The implementation of an exit charge under the existing regulation is of the consideration that the existing regulation has already embodied the legal authority for imposing a tax on the compensation that would arise when a business restructuring takes place in accordance with the sound business rationale that in the result is aligned with anti-avoidance purpose.

4.2.3.2 Entities Covered

Exit charge regime provisions vary across jurisdictions, which contain not only transfer pricing principles on business restructuring but also jurisdictions-specific considerations, such as the relationship between commercial law and tax law, the functional investment and business vehicles available therein, and the existing international agreements agreed among jurisdictions in a particular geographic region.

Although there are several business forms in Indonesia, such as limited company, limited partnership, and firm, the authors proposed the covered entity of the exit tax regime concerning business restructuring is a limited company and its permanent establishment.

Firstly, business restructuring involves transferring activities, assets, and valuable arrangements. This is likely to occur within resource-intensive entities or a function-diversified company. As such, a limited company is a highly possible entity to restructure.

Secondly, one of the main objectives of implementing an exit tax regime is the cross-border anti-avoidance purpose, which involves global investment and business activities in and out of Indonesia's jurisdiction. While foreign investment in Indonesia is one of the essential factors to boost the economy, it can only be carried out through shares ownership in a limited company established in Indonesia, as stipulated in Law Number 25 of 2007 on Foreign Investment Junto Presidential Regulation Number 10 of 2021 on Business Investment Activity.

4.2.3.3 The Triggering Events

Policy design regarding business restructuring is heavily intersecting with transfer pricing principles. Accordingly, the authors suggest the events that could trigger exit charge to be imposed on business restructuring begin with related party fulfillment as stipulated in article 18(4) of ITL and its implementing regulation, of which the proxies are shares ownership, controlling power, and cognition or marital relationship. This means that in the case of business restructuring, an exit charge will not be applied if the parties do not satisfy the related party definition.

Furthermore, the authors proposed to apply an exit charge once one of the following triggers is present in a business restructuring:

1. Transfer of the whole business function from Indonesia to another jurisdiction;
2. Transfer of tangible assets and intangible assets of an entity or a permanent establishment to another jurisdiction;
3. Transfer of an activity, through termination or substantial renegotiation of an existing arrangement, of a resident entity of Indonesia to another jurisdiction.

An exit charge should apply if a business restructuring occurs involving one of the triggers. Conversely, no exit charge should apply if the restructuring does not satisfy the related party transaction definition nor involves the triggering events.

For example, A Co., an Indonesian taxpayer, has been carrying out manufacturing, warehousing, distribution, and marketing functions in Indonesia. After a group restructuring, A co will no longer actuate those mentioned functions in Indonesia, as the manufacturing function will be transferred to its sister company in B jurisdiction. The restructuring satisfies the related party transaction definition and the triggering events, which are the transfer of activity through the termination of a resident entity of Indonesia to another jurisdiction. Therefore, an exit charge should be imposed.

The application of exit tax on cross-border business restructuring is illustrated in the following diagram on Figure 4.

4.3 Interplay with Tax Treaties

There could be a discussion of whether the exit tax interacts with the tax treaty when it deals with cross-border transfer of residency. The proposed exit tax on unrealized gain on migration relates to the distributive rule of capital gain in tax treaties in Article 13 OECD MTC and UN MTC (De Man et al.,2011; Chand, 2013). While the wording of Article 13 distributes taxing rights by the words "alienation", the exit tax is imposed on the unrealized gain. Accordingly, one of the debates to this extent is whether exit tax on change of residency to another jurisdiction is compatible with

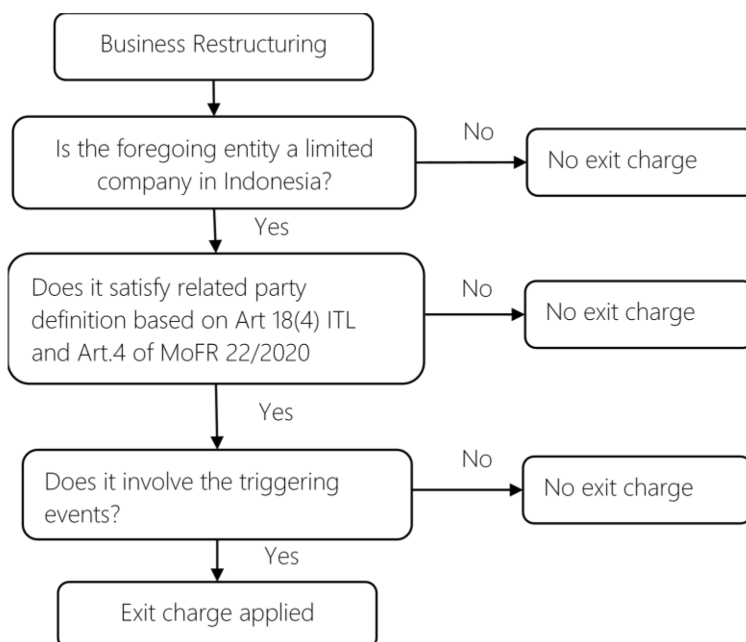

Figure 4 Illustration of Indonesia's Exit Charge Application
Source: resumed by the authors

article 13(5) OECD MTC, which allocates the taxing rights of capital gains to the residence state of the alienator with regard to 'other assets' in Article 13.

The wordings "The words "alienation of property" are used to cover in particular capital gains..' in Paragraph 5 Commentary on Article 13 OECD MTC imply that the term alienation is not limited to the sale or exchange of property (Moser, 2019). In fact, in the next paragraph, Paragraph 6 Commentary, OECD enunciates that whether there is a realization has to be determined according to the applicable domestic tax law. It is apparent that the coverage of Article 13 OECD MTC is not only for realized gains but also unrealized gains with recourse to domestic law.

Considering the interpretation of the Commentaries, the authors follow the conclusion of some scholars who come up with the broad meaning of "alienation" and conclude that Article 13(5) of the OECD MTC does not prevent the emigration state from levying an unrealized capital gain tax to its resident taxpayers[5]. In addition, it is a state's sovereignty to apply domestic law to its residents. Tax treaties do not prevent the application of domestic tax rules, according to which a person, immediately before ceasing to be a resident, is considered to have alienated property for capital gain tax purposes (OECD, 2015).

4.4 Double Taxation Issue

Another issue that has become subject to debate is the potential conflict of double taxation associated with the imposition of exit tax on change of tax residency by the State of emigration. This could be when the hosting country taxes the respective capital gains at the taxable amount established from the difference between the sale price and historical book value when they are realized. This means that the immigration State does not consider the market value of the assets at the moment when the taxpayer changes his residency, while on the other hand, the emigration State has already taxed the unrealized gains, which are calculated as the difference between the fair market value at the point of emigration and the historical book value.

[5] This reason supports the views of Chand (2013) and Moser (2019)

To illustrate, suppose Mr. A, an Indonesian resident, is emigrating to Singapore on 31 July 2020 and thus subject to exit tax on the unrealized gains at market value at the point of time prior to the departure. The exit tax is calculated at fair market value on 31 July 2020 minus the book value of the asset bought in 2015. Mr. A is deemed to have sold the assets before he emigrated. Five years later, in 2025, Mr. A's asset was sold while he was a Singaporean resident. In that case, if the capital gain tax in Singapore is calculated as selling price minus historical book value, the portion of gains unrealized in Indonesia would be taxed twice. A simple formula below could be drawn for a better understanding:

$$\boldsymbol{TTb = Te + Ti}$$

$$\boldsymbol{TTb = \%Te\ (FMv - Hbv) + \%Ti\ (Sv - Hbv)} \quad (1)$$

TTb = Total Burden
Te = tax in emigration State
Ti = tax in immigration State
% = Tax rate
FMv = Fair market value of an asset at the point of emigration
Hbv = Historical book value of an asset
Sv = Sales value of an asset

From the formula above, it could be noted that without any relief, double taxation can arise from both countries taxing the difference between the value of their tax bases and the asset's historical book value. Scholars have constructed two solutions based on the practices taken by countries levying exit tax. Firstly, granting the step-up value on the capital gain in the immigration State. A step-up basis refers to a tax policy that looks at the market value of assets at the time a person inherits them instead of the value when the prior owner purchased the assets[6].

In the illustration, as mentioned earlier, double taxation could be avoided by ensuring that Mr. A's assets are recognized at market value in Singapore immediately after Mr. A becomes a resident therein (step-up). In that way, when the gain is realized, the Singaporean capital gain tax will be imposed on the amount of the difference between the sale price and the fair market value at the time when the assets were first recorded in Singapore. Applying the step-up to the formula, each country would have a different portion of the cake of taxation on the asset in question. While Indonesia only taxes the difference between the fair market value at the point of emigration in 2020 and the historical book value in 2015, Singapore taxes the difference between the sales value in 2025 and the fair market value in 2020. The formula would be as follows:

$$TTb = \%Te\ (FMv - Hbv) + \%Ti\ (Sv - Fmv) \quad (2)$$

In the step-up context, Indonesia must ensure that the emigrating individual is provided with a step-up in the immigration State. Hence, bilateral negotiations between Indonesia and the hosting jurisdictions include a step-up clause in the tax treaties. Some states include step-up clauses on exit tax in their tax treaties, such as Canadian tax treaties, U.S. tax treaties, Denmark-South Africa DTC, and Germany-South Africa DTC. In the authors' opinion, it is likely a long way for Indonesia to implement this solution, considering the need to ratify its tax treaties.

Another approach is to apply a reverse credit method to relieve double taxation. For instance, countries like Canada and the Netherlands provide a reverse credit under domestic law to foreign tax paid for the pre-emigration portion of the gains (Chand, 2013). An illustration of the reverse credit can be made from the previous example. In the case at hand, since Singapore imposes a tax on the part of the gain subject to the Indonesian exit tax, the tax base is the difference between the fair market value at the emigration date in 2020 and the historical book value in 2015, a tax credit for the tax levied in Singapore in respect of the part of the gain can be provided by Indonesia. Adding variable of Foreign

[6] The definition by Wex Definition Team, Cornell Law School, Legal Information Institute can be accessed through https://www.law.cornell.edu/wex/stepped-up_basis. (accessed 28 July 2022)

Tax Credit (Ftr) to the formula could be drawn as follows:

$$TTb = Te + Ti - Ttr$$

$$TTb = \%Te\ (FMv - Hbv) + \%Ti\ (Sv - Hbv) - Ftr \quad (5)$$

$$TTb = \%Te\ (FMv - Hbv) + \%Ti\ (Sv - Hbv) - \%Ti\ (Fmv - Hbv) \quad (6)$$

$$TTb = \%Te\ (FMv - Hbv) + \%Ti\ (Sv - Fmv) \quad (3)$$

From the formula above, with the reverse tax credit, the total tax burden of the taxpayer will be levied only for the difference between sales value and historical book value; thus, no double taxation occurs. In the authors' opinion, following Chand (2013), the reverse credit method is suitable to adopt in Indonesia to relieve double taxation arising from the proposed immediate exit tax.

To that end, Indonesia could unilaterally include the reverse credit in Article 24 of the ITL scheme. This will answer why the authors opted for the ordinary annual income tax scheme instead of the final tax. If the final tax is in place, providing this reverse foreign tax credit to relieve double taxation will be challenging.

Another alternative, as suggested by the OECD, is bilateral negotiation through Mutual Agreement Procedure (MAP), where each State should provide relief as regards the exit tax that was levied by the other State on the part of the income that accrued while the person was a resident of that other State (OECD, 2015) could be considered.

5. CONCLUSION

In light of the growing trend in the transfer of residency and the reconfiguration of entities' valuable assets, functions, and structures through business restructuring, coupled with the diminishing effectiveness of existing anti-avoidance measures, it is increasingly imperative for Indonesia to adopt an exit tax mechanism to safeguard its tax base. This proposed exit tax regime can be seamlessly integrated into Indonesia's existing tax framework, offering an efficient implementation process devoid of excessive administrative burdens and protracted legislative procedures.

The proposed exit charge encompasses a spectrum of income tax provisions, applying specifically to changes in residency under capital gain tax regulations and specific business restructuring scenarios addressed through transfer pricing provisions. By adopting such a multifaceted approach, Indonesia can significantly enhance its ability to curb tax avoidance and protect its revenue streams. Furthermore, this pragmatic solution aligns with the global trend towards greater fiscal transparency and equity in taxation.

In conclusion, implementing an exit tax regime in Indonesia represents a viable and strategic step to preserve the nation's fiscal integrity while fostering an environment conducive to economic growth and investment. This research advocates adopting such a mechanism to fortify Indonesia's position in the global tax landscape and ensure that all stakeholders contribute equitably to the nation's socio-economic development.

6. IMPLICATIONS AND LIMITATIONS

The exit tax regime, while prevalent in several jurisdictions, has seen limited research and discussion in the context of Indonesia. This paper's policy recommendation offers a novel perspective on Indonesia's efforts to fortify its taxation system. This perspective is based on a comparative study of international best practices, thoughtfully considering Indonesia's unique variables, including its existing legal framework and tax system.

Furthermore, this study encourages a sequential approach to research on exit tax adoption in Indonesia. Future research endeavors are urged to incorporate statistical data to assess the concrete impact of exit tax regimes on revenue collection within different jurisdictions. This may encompass not only the positive effects of increased tax revenues but also a nuanced understanding of any adverse consequences, such

as potential impacts on foreign investment and the broader economy.

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