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Optimal Tax Policy for the Ultra-Rich in Indonesia: Enhancing Revenue and Social Equity

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ABSTRACT

This paper explores Indonesia's income tax policies by employing Mirrleesian optimal taxation theory to address revenue enhancement and social equity amidst a burgeoning population of high-net-worth individuals (HNWIs) and ultra-high-net-worth individuals (UHNWIs). Using a normative-quantitative approach with calibration and numerical simulation, the study draws on secondary data from Forbes, Knight Frank, the Directorate General of Taxes, and the World Bank, covering approximately 5,443 individuals in the top tax bracket in 2023. By analyzing wealth data and applying theoretical models, we identify the current top marginal tax rate of 35% as suboptimal and recommend an increase to 50%–75%. Our simulations demonstrate that higher tax rates, coupled with a reduction in tax avoidance and evasion, could boost tax revenue by up to Rp 36 trillion, significantly impacting poverty alleviation by lifting around 5.5 million individuals out of poverty. These findings imply that progressive tax reforms, complemented by stronger tax administration, are essential for reducing income inequality and fostering sustainable economic growth in Indonesia.

Keywords: mirrleesian optimal taxation, tax avoidance and evasion rate, ultra-high-net-worth individuals, progressive tax reforms, top marginal tax rate

1. INTRODUCTION

Indonesia, the largest economy in Southeast Asia, faces the critical challenge of maximizing its tax revenue to address substantial fiscal deficits and social inequalities exacerbated by the COVID-19 pandemic. Recent data from Knight Frank indicate a burgeoning population of wealthy Indonesians. The number of high-net-worth individuals (HNWIs)—those with net assets exceeding US$1 million—reached 36,742 in 2022 and is projected to grow to 56,436 by 2027, while the number of ultra-high-net-worth individuals (UHNWIs)—those with net assets exceeding US$30 million—reached 1,479 in 2023 and is projected to grow by 81.7% between 2026 and 2031, from 3,833 to 6,966 individuals, the fastest growth rate globally (Knight Frank, 2023; Knight Frank, 2024; Knight Frank, 2026). This growing wealth concentration, however, does not translate into significantly higher tax revenue, and it contrasts sharply with the nation's persistent poverty and rising income inequality (Oxfam, 2017; Wardhani & Malik, 2021; Djumena, 2023).In response, the Indonesian government has introduced measures to increase income tax rates for wealthy individuals. The Law No. 7 of 2021 on Harmonization of Tax Regulations (UU HPP), agreed upon by the government and

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the House of Representatives (DPR RI), introduces a progressive income tax rate of 35% for individuals with taxable income exceeding Rp 5 billion annually (Asmonah & Zena, 2023). This reform aims to address the substantial fiscal deficit due to extensive spending on economic recovery efforts following the pandemic. Although recent official reports show a significant reduction in the deficit, the question remains: can increasing the tax rate for wealthy individuals further boost tax revenue for public expenditure and reduce inequality?

The latter objective of Indonesia's tax policy reform, which is to address social inequality, is particularly important. The policy is grounded in the principle of "ability to pay," positing that individuals with higher incomes should bear a greater tax burden to support societal needs (Saez, 2017). The new tax structure, which includes more brackets, is intended to make the tax system more progressive and equitable, aligning Indonesia more closely with other countries in the region. Indonesia's poverty rate and the Gini coefficient, which highlights the gap between the rich and the poor, have been points of concern (World Bank, 2023).

Despite these reforms and their apparent success in increasing tax revenue and reducing the budget deficit, there is ongoing debate regarding the optimal top tax rate. Some argue that the current rate of 35% may not be sufficient to significantly impact income inequality and suggest that higher rates, similar to those in OECD countries, such as Belgium and Finland, where top rates are more than 65%, could be more effective (Tax Foundation, 2026). On the other hand, critics raise concerns about potential negative effects on investment and economic growth if tax rates are increased too aggressively (Mankiw, 2013). Balancing the need for sufficient revenue with maintaining a conducive environment for economic activity remains a contentious issue.

This research aims to fill the gap on the issue of optimal taxation, particularly concerning the super-rich group of individuals in Indonesia (throughout this paper, the terms "ultra-rich," "super-rich," and "super-rich group" are used interchangeably with HNWIs and UHNWIs, referring to the same group of wealthy individuals). Using theoretical research methods from the literature in this issue, the current research conducts numerical simulation to find the possible range of the optimal top marginal income tax rate. To the best of my knowledge, no research has been conducted on this specific issue using the foundation of Mirrleesian optimal taxation theory in the context of Indonesian income tax. Therefore, this study is essential to understand the effectiveness of recent tax reforms in generating revenue and addressing income inequality. It also explores the potential for further reforms and their implications for economic growth and social equity.

The next section provides the theoretical framework as a foundation to find the optimal marginal tax rate for super-rich individuals in Indonesia. The third section discusess the state of affairs on Indonesian income tax as the main revenue source for the government to finance public expenditure, with a particular focus on the recent tax reform that increased the tax rate for high-income individuals. The following section discusses social equity, or the lack thereof, in the Indonesian economy and the potential solution that the new progressive tax structure can provide in reducing income inequality. Finally, the paper delves into numerical simulations covering different scenarios of optimal tax rates for super-rich individuals, providing a framework to assess and guide future tax policy decisions.

2. THEORETICAL FRAMEWORK AND HYPOTHESIS DEVELOPMENT

The normative question of how much tax should be imposed on HNWIs and UHNWIs in Indonesia remains a subject of intense debate. Scholars and practitioners argue that the current top marginal rate of 35% is insufficient to enhance tax revenue and social equity (Agung, 2021; Damayanti, 2023; Cahyadi, 2024). Scientifically, addressing such

inquiries often invokes principles articulated by Mirrlees (1971), which suggest that individuals' ability to earn higher incomes is influenced by exogenous factors beyond their control and unobservable personal information. As each individual operates behind a "veil of ignorance" regarding their position in the income distribution, this motivates the government to implement income redistribution policies through progressive taxation, particularly aimed at redistributing income from the affluent to the less privileged.

Balancing the reduction in inequality through tax redistribution needs careful consideration of the disincentive effects it may entail. Finding the optimal composition to address this trade-off is inherently challenging, often a focal point of political debate in selecting a social welfare function aligned with a nation's policy doctrine, making it vulnerable to lobbying and political capture.

From a scientific perspective, economists generally agree on the normative principle of Pareto efficiency to determine optimal tax rates that all parties can accept, thereby achieving income redistribution goals. Werning (2007) and Scheuer and Werning (2016) have extensively discussed the mechanisms for determining optimal tax rates, focusing on their effects on tax revenues, especially from the HNWI and UHNWI taxpayer groups. Utilizing the Laffer curve, they illustrate that tax rates on the right side of the peak represent Pareto inefficiency, while rates on the left side are not Pareto, optimal as they could be increased without distorting economic productivity. As Scheuer and Slemrod (2020) stated, calculating the Pareto efficient income tax rate T(y) and maximizing tax revenues depends on three crucial parameters: the income compensation elasticity or taxable income elasticity ϵ(y), the income effect η(y), and the income distribution shape h(y).

In contexts demonstrating changes in income distribution h(y) (e.g., due to changes in income tax rates) among high-income taxpayers, this dynamic can be depicted using local Pareto parameters:

$$\rho(y) \equiv -1 + \frac{yh'(y)}{h(y)} \quad (1)$$

This Pareto parameter helps determine the concentration of high-income taxpayers and the influence of optimal tax rate policies, especially those maximizing tax revenues without distorting economic activity. Intuitively, a higher parameter indicates a larger proportion of high-income taxpayers, allowing for increased tax rate progressivity.

If income compensation elasticity $\epsilon(y)$ and marginal tax rate $T'(y)$ do not locally vary with y, Scheuer and Werning (2016) state that the simple formula below defines the upper limit of the optimal marginal tax rate $T'(y)$ at income level y:

$$T'(y) \leq \frac{1}{1+\rho(y)\epsilon(y)-\eta(y)} \quad (2)$$

This formula shows that when income compensation elasticity ϵ is high, tax rate changes cause significant distortions through taxpayer responses, potentially reducing their income if tax burdens increase. Consequently, the upper limit of the marginal tax rate becomes relatively smaller. Conversely, a significant income effect η indicates that taxpayers respond to tax rate increases by working more, feeling poorer due to increased tax burdens, thereby offsetting income reductions. This increases the tax base, allowing for a higher upper limit of the marginal tax rate.

Understanding the concept of local Pareto parameters (ρ) is crucial in determining whether changes in marginal tax rates will increase or decrease total tax revenue (Saez et.al, 2012). For instance, when lowering income tax rates $T(y)$ at a certain income level y, policymakers need to observe the type and magnitude of taxpayer behavior responses. If existing responses lead to increased tax revenues, it suggests a local Laffer effect indicating that previous tax rates were not Pareto efficient. In this scenario, according to Saez (2017), two types of effects from tax burden changes emerge:

1. Mechanical Effect: A reduction in tax rates leads to decreased revenues from taxpayers previously earning at level y.

2. Behavioral Effects: Generated by two groups of taxpayers:
    - For taxpayers initially earning slightly above y, the response is to decrease their income to reduce it to y, leading to reduced tax revenue.
    - For taxpayers initially earning slightly below y, the response is to increase their income (motivated by tax cuts at y), resulting in increased tax revenue for the state.

Based on these cases, the total effect on tax revenue depends on the shape of the local income density $h(y)$. A steep decline in $h'(y)$ due to a reduction in income tax rates at (y) implies many taxpayers initially earning below y respond by increasing their income to y to benefit from favorable tax rates. Consequently, total tax revenue increases due to a larger tax base. In such cases, a high local Pareto parameter $\rho(y)$ indicates that the local peak of the Laffer curve is reached by reducing the marginal tax rate.

The upper limit of the marginal tax rate derived from formula (2) serves as a natural benchmark for the current applicable rates. This is particularly relevant to the focus of this article and the heated public debate on the optimal tax rates for high-income taxpayers. If the government aims to maximize tax revenues as efficiently as possible without distorting the economy and simultaneously enhance social justice, as outlined by Mirrlees, then a serious study of optimal and progressive tax rates is warranted (Diamond & Saez, 2011). Aligning with the diminishing marginal utility criterion places minimal weight on the super-rich individual groups, thereby lowering the optimal tax rate burden on their incomes.

The formula (2) applies universally and can be applied to cases discussed by Phelps (1973), Sadka (1976), and Seade (1977) regarding zero percent marginal tax rates for the last rupiah earned by the highest-income taxpayers. In income distributions with upper bounds, changes in $h(y)$ reduce to zero precisely at the distribution point of the wealthiest individuals, resulting in a local Pareto parameter $\rho(y)$ rising infinitely. This implies that the marginal tax rate for the highest-income taxpayers is Pareto efficient at zero.

This may initially seem counterintuitive by exempting the wealthiest from tax burdens on their marginal income. However, this rate only applies specifically to one taxpayer at the peak of the income distribution and not to other high-income taxpayer groups below it. Furthermore, a more substantive reason relates to economic efficiency; the income effect from the wealthiest taxpayers responding negatively to tax burdens on the last rupiah earned results in economic inefficiency. Pareto long ago observed the phenomenon of distribution among individuals in the highest income distribution, later referred to by economists as Pareto distribution. Scheuer and Slemrod (2020) summarize the Pareto parameter equation as follows:

$$\rho(y) = -1 + \frac{yh'(y)}{h(y)} = \frac{yh(y)}{1-H(y)} = \frac{E[y'|y' \geq y]}{E[y'|y' \geq y]-y} \quad (3)$$

This fat-tailed distribution is independent of $\mathbf{y}$, making the local Pareto parameter $\boldsymbol{\rho}$ constant. Therefore, formula (1) also aligns with the optimal asymptotic marginal tax rates characterized by Saez (2001) or Diamond (1998) for cases without income effects.

3. RESEARCH METHODOLOGY

This study employs a normative-quantitative approach using calibration and numerical simulation based on the Mirrleesian optimal taxation framework. The analysis draws on secondary data from Forbes (Ho & Karmali, 2024), The Wealth Report published by Knight Frank (Knight Frank, 2023), the Directorate General of Taxes (Rachman, 2023), Badan Pusat Statistik (Badan Pusat Statistik, 2023), and the World Bank (World Bank, 2023).

The analytical procedure consists of four steps. First, due to the lack of taxable income data for UHNWIs in Indonesia, the Pareto parameter ρ is estimated indirectly using wealth data from Forbes (Ho & Karmali, 2024) and Knight Frank (2023), following a conservative assumption of a constant wealth-to-taxable-income (W-to-TI) transformation rate. This ratio is conceptually related to the income-to-wealth ratio used in the

wealth inequality literature (Piketty & Zucman, 2014). Second, the elasticity of taxable income (ETI) is calibrated from the existing literature, with a consensus value of approximately 0.3 (Gruber & Saez, 2002; Saez et al., 2012). Third, the tax avoidance and evasion (TAE) rate is estimated by calculating the percentage difference between potential and realized tax revenue based on data from tax officials for the 5,443 individuals in the top bracket in 2023 (Rachman, 2023). This TAE rate represents a simplified measure of the broader tax gap concept discussed in the literature (Slemrod & Yitzhaki, 2002; UNU-WIDER, 2024). Fourth, using formula (2), the optimal top marginal tax rate is then simulated under different scenarios of ETI, ρ, and the W-to-TI transformation rate.

The main limitations of this methodology are the use of wealth data as a proxy for taxable income, the absence of panel data on Indonesian UHNWIs, and the estimation of the TAE rate from a single data point. These limitations are acknowledged, and the results should be interpreted as indicative rather than definitive.

4. RESULTS AND DISCUSSIONS

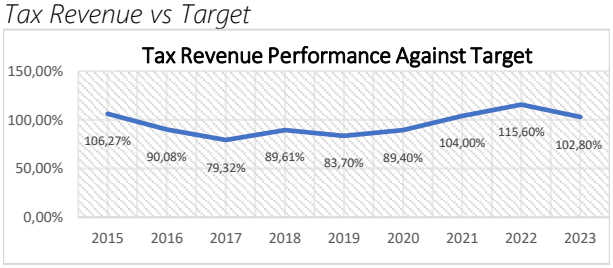
4.1 Indonesian Income Tax Policy Performance in Generating Revenue

The efficacy of income tax policy in generating revenue is crucial for any government's ability to finance public expenditures and achieve socio-economic objectives. Indonesia's income tax policy offers a valuable case study due to its evolving tax structure, tax administration, and the challenges it faces as a developing economy. This analysis evaluates the performance of Indonesia's income tax policy in generating government revenue, drawing on recent data and scholarly insights.

Indonesia's tax revenue, particularly from income tax, has fluctuated due to various economic and administrative factors. According to data from the Ministry of Finance, tax revenues have consistently increased over the last three years, from 2021 to 2023, meeting government targets (Kementerian Keuangan Republik Indonesia, 2024). This contrasts with previous years, notably 2020, when tax revenue reached IDR 1,072.1 trillion, only 89.4% of the target set in the state budget (see Figure 1 below).

Figure 1

Tax Revenue vs Target

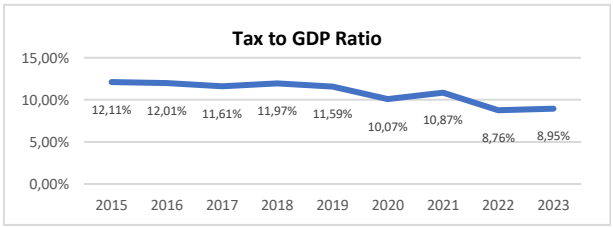


Note. Source: Kementerian Keuangan Republik Indonesia (2024)

Despite recent successes in meeting tax revenue targets, there is significant room for improvement. Fitch Ratings' credit rating of BBB for Indonesia is below that of other ASEAN countries such as Thailand, the Philippines, Malaysia, and Singapore (Fitch Ratings, 2024). One reason for this rating is Indonesia's relatively low tax ratio, consistently below 12% over the last five years (see Figure 2 below). This tax ratio is significantly lower than the Asian average of 14.9%, the recommended ratio by the World Bank. By comparison, the average tax-to-GDP ratio among OECD countries stands at 34.1% (Organisation for Economic Co-operation and Development, 2026).

Figure 2

Tax to GDP Ratio



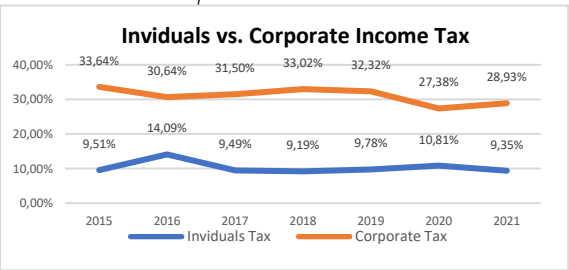
Note. Source: Calculated from Kementerian Keuangan Republik Indonesia (2024) and Badan Pusat Statistik (2023)

One indicator of suboptimal income tax revenue in Indonesia is the comparison of individual and corporate income tax contributions to total tax revenue (see Figure 3 below). Corporate income tax revenue is significantly higher than individual income tax revenue. In 2025, corporate income tax revenue contributed 16.76%, compared to individual income tax revenue's 12.94% (Kementerian Keuangan Republik Indonesia, 2025). This pattern, typical in

developing countries, reflects a tax administration infrastructure that focuses on big corporations rather than a broader tax base. In OECD countries, individual taxes contribute 23.9% to total tax revenue, while corporate taxes make up only 9.5% (Enache, 2020).

Figure 3

Individuals vs. Corporate Income Tax



Note. Source: Kementerian Keuangan Republik Indonesia (2024)

These patterns highlight several structural and administrative challenges that undermine the effectiveness of Indonesia's income tax policy. Three major challenges need addressing. First, a narrow tax base limits the government's ability to collect income tax from a broader population, exacerbated by a significant informal sector (Wakang, 2024). Second, tax compliance and evasion remain critical issues. The World Bank estimates that Indonesia's tax compliance rate is among the lowest in the region, with high incidences of tax evasion and avoidance due to inadequate enforcement mechanisms (World Bank, 2020a). Third, inefficiencies in tax administration persist. The World Bank's Ease of Doing Business report notes that the time required to comply with tax obligations in Indonesia is significantly higher than in other ASEAN countries (World Bank, 2020b).

To address these challenges, several fiscal policies can be utilized by the Indonesian government. Notably, Indonesia has made some fiscal reforms to broaden the tax base and improve compliance, such as the 2016 tax amnesty program, which added approximately IDR 114 trillion to state coffers, digitalization of tax administration, and regulatory changes like Law No. 7 of 2021, which increased the tax rate for top earners (Saputra, 2021).

While these efforts are commendable and need support, current data suggests they are not aggressive enough to significantly increase tax revenue. Indonesia can learn from successful programs like the US IRS's Earned Income Tax Credit (EITC), which stimulates tax return filings through tax credits for working people with certain income thresholds (Chetty et al., 2013). This program boosts tax return filings and stimulates the economy by encouraging people to work and take advantage of tax credits. It also effectively provides subsidies to poor families, directly targeting subsidy recipients compared to other indirect and often wasteful subsidy programs, such as gasoline subsidies (Sampe, 2023).

A potential policy that is the focus of this paper, discussed in detail in a later section, is increasing the tax rate for wealthy and ultra-wealthy individuals. Taxing this group not only has the potential to increase tax revenue but also to enhance social equity, addressing the persistent issue of income inequality in Indonesia. This inequality generates numerous social problems, which will be discussed in the next section.

4.2 Tax Revenue and Social Equity in Indonesia

Taxation plays a critical role in redistributing wealth and reducing income inequality within a nation. For Indonesia, Southeast Asia's largest economy, this goal is particularly relevant given the significant growth in its population of ultra-rich individuals. Despite various economic challenges, the number of high-net-worth individuals (HNWIs) and ultra-high-net-worth individuals (UHNWIs) in Indonesia has been rapidly increasing, presenting an opportunity for the government to address social disparities through targeted tax policies.

According to The Wealth Report 2023 published by Knight Frank, Indonesia had 36,742 HNWIs—individuals with a net worth exceeding US$1 million—in 2022, and this number is projected to grow by 53.6% to 56,436 by 2027 (Knight Frank, 2023). More recent data from The Wealth Report 2024 shows that Indonesia had 1,479 UHNWIs—individuals with net assets exceeding US$30 million—in 2023, with

projections to reach 1,984 by 2028 (Knight Frank, 2024). Furthermore, The Wealth Report 2026 projects that Indonesia's UHNWI population will grow by 81.7% between 2026 and 2031, from 3,833 to 6,966 individuals, the fastest growth rate globally (Knight Frank, 2026). This burgeoning wealth concentration starkly contrasts with the persistent poverty affecting a significant portion of the population. Despite the increasing wealth among the richest Indonesians, the country faces profound challenges in poverty alleviation. As of March 2023, Indonesia recorded 26 million people living in poverty, equating to 9.36% of the population (Badan Pusat Statistik, 2023). This figure represents the highest level of poverty in the country in the past three years. Furthermore, the Gini coefficient, a measure of income inequality, rose from 0.3 in 2000 to 0.4 in 2015, indicating growing disparities in income distribution. The latest data from the World Bank shows that the Gini coefficient has remained high, fluctuating around 0.38 to 0.39 in recent years (World Bank, 2023) (see Figure 5 below).

The wealth disparity is further highlighted by data showing that the combined wealth of Indonesia's four richest individuals surpasses the total wealth of the 100 million poorest Indonesians (Oxfam, 2017). According to Forbes, the 50 wealthiest Indonesians in 2024 held a combined wealth of US$263 billion, reflecting the extreme concentration of wealth within the country (Ho & Karmali, 2024). Income inequality in Indonesia has far-reaching social implications. The stark contrast between the wealth of the richest individuals and the poverty experienced by millions poses a threat to social stability and democratic quality. Notably, Indonesia ranks as the sixth most unequal country globally regarding wealth distribution (World Bank, 2023). This profound inequality can undermine social cohesion and lead to increased social tensions.

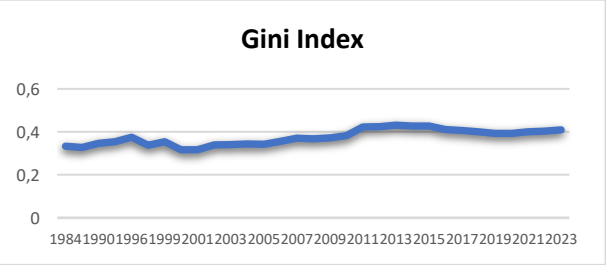
The recent increase in the income tax rate, as stipulated in Law No. 7 of 2021, for individuals earning over Rp 5 billion annually from 30% to 35% is a step towards enhancing tax revenue from the wealthy. However, there is potential to further increase the maximum income tax rate to 45% or even 50%, aligning Indonesia with higher-tax countries like Belgium and Finland, which levy rates of more than 60%. In addition to income tax reforms, implementing a wealth tax could be an effective tool for wealth redistribution. A wealth tax targets the net wealth of individuals, thereby capturing a broader base of wealth held by the richest segments of society. This approach can provide the government with additional resources to fund social programs and economic initiatives aimed at reducing poverty and inequality. However, the subject of wealth tax requires separate discussion and is not the subject of the current paper.

Leveraging tax revenue from Indonesia's growing population of wealthy individuals can significantly impact social equity. By reforming the income tax system and introducing new wealth taxes, the Indonesian government can address the widening gap between the rich and poor, promote economic stability, and enhance social cohesion. Effective tax policies that redistribute wealth are essential for fostering a more equitable society and ensuring sustainable economic growth in Indonesia.

As Indonesia considers increasing the tax rate on its wealthiest citizens, a critical question arises: What should the appropriate tax rate be? This question warrants a detailed analysis, balancing the need for increased revenue with the potential economic impact on investment and growth. The next section will explore this issue in depth, evaluating different tax rate scenarios and their implications for Indonesia's economy and social equity.

Figure 4

Indonesia's Gini Index



Note. Source: World Bank (2023)

4.3 Numerical Simulations of Optimal Top Marginal Tax Rates

Calculating the optimal tax rates for HNWIs and UHNWIs in Indonesia presents significant challenges due to limited data availability. In contrast, scholars studying the U.S. tax system benefit from comprehensive and transparent data from the IRS, facilitating numerical calculations, simulations, and empirical research. For instance, Piketty and Saez (2013) have used U.S. data to find that the value of ρ(y) converges to approximately 1.4 at the top income levels, with negligible income effects (η=0). The zero income effect arises because changes in income for wealthy individuals typically do not alter their work behaviors, as their motivations are more aligned with self-actualization rather than income generation. Additionally, the elasticity of taxable income (ETI) is estimated to be around 0.3, lying in the middle of the estimated range (Saez et al., 2012). This yields an upper limit of the highest marginal tax rate of around 70% (1/(1+1.4·0.3)). This U.S. benchmark provides a useful reference point for the Indonesian case, though the lower ρ value in Indonesia (as estimated below) suggests that the optimal rate may differ.

Due to the lack of data on taxable income for UHNWIs in Indonesia, we estimate ρ indirectly using wealth data from Forbes (Ho & Karmali, 2024) and The Wealth Report published by Knight Frank (Knight Frank, 2026). Although using wealth instead of taxable income can be problematic, a conservative estimation of the rate of wealth-to-taxable income (W to TI) transformation should provide a useful benchmark for future policy reform. Assuming a constant rate of W to TI, we can obtain the same value of ρ using either method. This assumption is necessary because Indonesia does not publish individual-level taxable income data disaggregated at the top of the distribution, a limitation shared by many developing economies (Saez et al., 2012).

To estimate the wealth distribution of individuals with taxable income in excess of Rp 5 billion annually, we use three complementary data points that together allow us to triangulate the wealth distribution. First, government officials have stated that 5,443 individuals fell into the top tax bracket in 2023 (Rachman, 2023), which defines the population size of our analysis. Second, Forbes reports 32 Indonesian billionaires with a total wealth of Rp 3,251 trillion (approximately Rp 101 trillion per person) (Ho & Karmali, 2024), which provides the top anchor of the wealth distribution. Third, Knight Frank identifies 556 Indonesians with net wealth above USD 100 million (approximately Rp 1,600 billion) (Knight Frank, 2023), which gives an intermediate anchor. These three sources are used because no single source covers the entire top bracket population; Forbes tracks only billionaires, Knight Frank covers a broader UHNWI segment, and DJP provides the population count but not individual wealth. Therefore, we estimate the wealth of the 33rd to 556th richest individuals at around Rp 2,000 billion per person. The remaining 4,887 individuals are estimated to have an average wealth of Rp 75 billion, which is a conservative estimate. Together, the total wealth of the 5,443 top-tier income individuals is Rp 4,665 trillion, representing an average wealth of Rp 857 billion.

This estimate carries several caveats. First, it assumes that the wealth distribution within each segment is uniform, which likely understates the concentration at the very top. Second, it assumes that the DJP population (taxable income above Rp 5 billion) corresponds to the Knight Frank and Forbes populations (net wealth thresholds), which may not hold if wealth and income are imperfectly correlated. Third, the estimate of Rp 75 billion for the remaining 4,887 individuals is a lower-bound estimate; if their actual wealth is higher, the resulting ρ would be lower, and the optimal tax rate would be higher. These caveats are acknowledged, and the sensitivity of the results to these assumptions is discussed below.

Using formula (3), we calculate the value of ρ, representing the thickness of the wealth distribution, as follows:

$$\rho = \frac{857}{857-75} = 1.10 \quad (4)$$

This value is lower than the U.S. benchmark of 1.4 (Piketty & Saez, 2013), suggesting a thinner tail in Indonesia's wealth distribution. Intuitively, this means that the concentration of wealthy

individuals in Indonesia is less extreme than in the U.S., which would—all else equal—imply a higher optimal tax rate (since the tax base is less sensitive to rate changes at the top). With this value of ρ and different ETI values, we estimate the optimal tax rate for high-income individuals. Gruber and Saez (2002) provide ETI values for different income levels, with a consensus of around 0.3. However, scholars warn that ETI is not fixed and varies with economic conditions (Saez et al., 2012). Table 1 shows different ETI scenarios and their corresponding top tax rates in Indonesia.

From Table 1, we can see that for the consensus ETI of 0.3, the optimal tax rate for top bracket individuals is 75%. This is significantly higher than the current tax rate of 35%. Even under a more conservative assumption of ETI = 0.5, the optimal rate remains well above the current rate. This finding is robust to reasonable variations in the ETI parameter.

Table 1

Top Marginal Tax Rate Derived from Different ETIs

ETI	Tax Rate
0.3	0.75
0.5	0.65
0.7	0.57
0.9	0.50

Note. Source: Researcher's calculations

In Table 2, we estimate the tax avoidance and evasion (TAE) rate using data provided by tax officials. It is important to note that this rate is a simplified measure of the broader tax gap concept, which in the literature comprises multiple components including under-reporting, non-filing, non-payment, and non-registration gaps (UNU-WIDER, 2024). This is done by calculating the percentage difference between the potential total tax revenue (TTR) and the realized TTR, yielding a TAE rate of 55%. This rate reflects the potential tax revenue lost due to inefficiencies or loopholes with regard to the tax base and/or lack of enforcement by tax administrations, such as tax expenditures, illegal tax evasion, or other causes.

The TAE rate of 55% represents a minimum estimate, derived from taxable incomes precisely at the cutoff threshold of Rp 5 billion for approximately 5,443 individuals who filed their tax returns in 2023. This estimate is conservative because it assumes that all 5,443 individuals report income exactly at the threshold; if some report higher incomes, the realized TTR would be higher, and the TAE rate would be lower. Conversely, if some should have reported but did not file, the true TAE rate would be higher. This straightforward calculation may vary from other methodologies, given the diverse approaches to measuring tax compliance and evasion documented in the literature (Hanlon & Heitzman, 2010; Gebhart, 2017; Lisowsky et al., 2013; Salihu et al., 2013; UNU-WIDER, 2024).

Using the information above, we simulate different tax revenues generated by two top marginal tax rates (50% and 75%) across three scenarios of wealth-to-income transformation rates (1.5%, 1%, and 0.6%). These three scenarios are chosen to bracket the plausible range: the 1.5% rate is conservative given the current Central Bank rate of approximately 6% (as it implies a low return on wealth), the 1% rate is an intermediate case, and the 0.6% rate corresponds to the threshold required to classify 5,443 individuals into the highest tax bracket. Table 3 presents the simulation results for top marginal tax rates of 50% and 75%. The 75% tax rate is derived from an ETI of 0.3, reflecting the scholarly consensus, while the 50% tax rate corresponds to an ETI of 0.9, representing a worse scenario with an extremely high behavioral response from HNWIs and UHNWIs. The 50% rate therefore serves as a lower-bound estimate that is

Table 2

The Baseline Parameters Based on Current Realized TTR

Avg Wealth*	Conversion rate	Avg TI*	Avg Tax Revenue*	Total Individuals	Total Tax Revenue (TTR)*	Realized TTR*	TAE rate
857	0.58%	5.00	1.44	5,443	7,859.69	3,500.00	55%

Note. Source: Researcher's calculations

* In Rp. Billions

robust even under extreme assumptions about behavioral responses. Thus, even in a worst-case scenario characterized by significant economic distortion and a high ETI, there remains plenty of room to increase the tax rate.

The simulation results in Table 3 show considerable variation depending on the parameters, but the direction is consistent: higher top rates and lower TAE rates both increase revenue. The robustness of this finding can be assessed by examining the range of outcomes: from a conservative estimate of Rp 200 billion in additional revenue to an optimistic estimate of Rp 36 trillion, depending on the assumptions. This wide range reflects genuine uncertainty about behavioral responses and the wealth distribution, rather than a flaw in the methodology. The policy implication is that even under the most conservative assumptions, there is room to increase the top rate without reducing revenue.

More specifically, Table 3 shows that if the TAE rate is reduced to zero through both enhanced tax base efficiency and rigorous tax administration enforcement, potential total tax revenue could increase to approximately Rp 8 trillion, representing a 56% increase from the current Rp 3.5 trillion collected from HNWIs and UHNWIs. Additionally, if the transformation rate—which reflects our uncertainty regarding the distribution of wealth among individuals—increases to 1%, tax revenue would similarly rise by about 56%. In the best-case scenario, with the TAE rate minimized (within the tax agency's control) and the transformation rate maximized (beyond the tax agency's control), total tax revenue could surge to around Rp 29 trillion. This figure would be even higher with a top marginal tax rate of 75%, potentially yielding over Rp 37 trillion in total tax revenue.

To contextualize these findings, it is useful to compare them with the U.S. benchmark. In the U.S., the optimal top rate is estimated at around 70% (Piketty & Saez, 2013), which is within the range of our Indonesian estimates (50%–75%). The similarity suggests that despite institutional differences, the basic trade-off between equity and efficiency at the top of the income distribution is broadly comparable across countries. However, the lower ρ value in Indonesia implies that the revenue-maximizing rate may be toward the higher end of the range.

The simulation shows that increasing the top tax rate will increase total tax revenue. However, the significance of this increase depends on the top marginal tax rate, the transformation rate, and the TAE rate. Using the most conservative parameters, the increase may be around Rp 200 billion, or 0.0002% of current tax revenue. Using the most optimistic parameters, we get an additional 4% of current tax revenue, representing an extra Rp 36 trillion for the government. This amount, if transferred directly to the less fortunate, could lift around 5.5 million people out of poverty in Indonesia, which represents 20% of the poor population in this country.

The practical implication of this analysis is that the Indonesian government has a clear fiscal opportunity: the current top rate of 35% is below

Table 3

Simulated Total Tax Revenue at Top Marginal Tax Rate of 50% and 75%

Marginal Tax Rate	Avg Wealth*	W to TI rate	Avg TI*	Avg Tax Revenue*	Total Individuals	Total Tax Revenue (TTR)*	TTR at current TAE rate*
50%	857	1.50%	12.86	5.37	5,443	29,245.13	13,160.31
50%	857	1.00%	8.57	3.23	5,443	17,580.82	7,911.37
50%	857	0.60%	5.14	1.52	5,443	8,249.37	3,712.22
75%	857	1.50%	12.86	7.34	5,443	39,937.85	17,972.03
75%	857	1.00%	8.57	4.12	5,443	22,441.38	10,098.62
75%	857	0.60%	5.14	1.55	5,443	8,444.20	3,799.89

Note. Source: Researcher's calculations

* in Rp. Billions

the estimated optimal range of 50%–75%. However, the realization of this potential depends critically on complementary reforms in tax administration to reduce the TAE rate, as well as on the design of transfer mechanisms to ensure that additional revenue is effectively targeted toward poverty alleviation.

5. CONCLUSION

The analysis of Indonesia's income tax policy highlights both its achievements and challenges in generating revenue and promoting social equity. Recent data show a positive trend in meeting tax revenue targets, but significant room for improvement remains, especially compared to other developing countries. Despite Indonesia's growing population of HNWIs and UHNWIs, the country's tax ratio remains low, and income inequality is stark, posing threats to social stability and democratic quality.

This study set out to answer a specific question: what is the optimal top marginal tax rate for HNWIs and UHNWIs in Indonesia, and how far is the current policy from that optimum? The numerical simulations, grounded in the Mirrleesian optimal taxation framework, provide a clear answer. Using conservative estimates and scholarly models, the analysis suggests an optimal top marginal tax rate in the range of 50% to 75%. This range is derived from a Pareto parameter (ρ) estimated at 1.10—lower than the U.S. benchmark of 1.4—and a consensus elasticity of taxable income (ETI) of 0.3, with the 50% lower bound corresponding to a worst-case ETI of 0.9. The current top rate of 35% is therefore significantly below the estimated optimal range. Even under the most conservative assumptions about behavioral responses, there remains room to increase the top rate without reducing revenue. This finding is consistent with the international literature: International Monetary Fund (2013) estimates revenue-maximizing rates for most OECD countries to lie between 45% and 70%, and Diamond and Saez (2011) advocate a rate of 73% for the U.S.

To address these issues, the government must consider more aggressive fiscal policies, particularly targeting the wealthiest segments of society. Increasing the top marginal tax rate for high-income individuals could enhance revenue generation and social equity. Furthermore, addressing tax avoidance and evasion is critical. Reducing the Tax Avoidance and Evasion (TAE) rate, which currently stands at an estimated 55%, through better tax base efficiency and rigorous tax administration, could dramatically increase total tax revenue. Simulations indicate that under very conservative assumptions of income distribution among the wealthy population, the government could potentially raise an additional Rp 36 trillion, enough to significantly impact poverty alleviation.

6. IMPLICATIONS AND LIMITATIONS

The practical implications of these findings are twofold. First, the government has a clear fiscal opportunity: the current top rate of 35% is below the estimated optimal range, and increasing it to at least 50% would align Indonesia with international benchmarks. Second, the realization of this potential depends critically on complementary reforms in tax administration. The TAE rate of 55% suggests that more than half of potential revenue from this group is currently lost. Reducing this rate through enhanced data transparency, risk-based audit selection, and stronger enforcement against high-wealth individuals could yield substantial revenue gains even without changing the statutory rate. The Indonesian tax authority (DJP) could prioritize the approximately 5,443 individuals in the top bracket for enhanced compliance monitoring, leveraging third-party data from financial institutions and cross-border information exchange.

Several limitations of this study should be acknowledged. First, the estimation of the Pareto parameter (ρ) relies on wealth data from Forbes and Knight Frank rather than taxable income data, due to the unavailability of individual-level income data at the top of Indonesia's distribution. While this approach provides a useful benchmark, the assumption of a constant wealth-to-taxable-income transformation rate introduces uncertainty. Second, the TAE rate of 55% is estimated from a single data point—the 5,443 individuals at the Rp

5 billion threshold—and represents a simplified measure of the broader tax gap concept. Third, the analysis is static and does not account for dynamic behavioral responses, such as long-term effects on investment, capital flight, or income shifting to corporate forms. These limitations suggest that the results should be interpreted as indicative rather than definitive, and they point to clear priorities for future research.

Finally, this research focuses exclusively on income tax policies and their potential impact on wealth redistribution and social equity in Indonesia. While other forms of taxation—such as wealth taxes, inheritance taxes, or adjustments to final income tax on capital gains—could also play a role in addressing inequality, they fall outside the scope of this study. The literature suggests that wealth taxes and reforms to final tax regimes could complement income tax reforms by capturing income that escapes the progressive schedule. Future research could explore these instruments using similar Mirrleesian frameworks, preferably with access to administrative tax data at the individual level, which would enable more precise estimation of ETI and ρ for Indonesia.

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