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TAX REFORM IN AN EFFORT TO INCREASE REVENUE IN TIMOR LESTE TAX SECTOR: A LITERATURE REVIEW

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Abstract
This study aims to highlight the profile and composition of tax revenues, discuss the main issues that can hinder the effectiveness of tax implementation, and offer possible suggestions for tax reform in Timor Leste. The tax contribution in Timor Leste is an average of 10% and 5% of non-tax state revenues, while the oil and gas sector contributes an average of 85% to Timor Leste's state revenue. The broad goal of tax reform in many low-income countries is to move from dependence on import (and export) taxation to domestic taxation by broadening the tax base - by introducing a value-added tax and broadening the individual income tax base.
***Keywords**: tax reform, tax application, value-added tax, income tax*

I. Introduction

Taxes have a crucial role in the state's life, especially in implementing development, because taxes are a source of state income to finance all expenditures, including development expenditures. Tanzi (2014) states that taxation is a potentially important instrument that the government can use to encourage capital accumulation and make the country's economy grow faster. Tax revenues in both developed and developing countries are the primary source of sustainability and economic growth (Chemingui et al., 2008).

On the other hand, the mining sector, which a few large companies dominate, can generate a sizeable taxable surplus (Gupta, 2007). Thus it can increase income so that national resources to total income will be positive, as obtained in previous studies by Bahl (1971), Chelliah et al. (1975), and Tait et al. (1979). However, as Vazquez (2001) points out, resource-dependent countries have insufficient capacity to collect tax revenues. Thus, the relationship between natural resource and non-resource tax revenues for these countries is generally negative. Basheer et al. (2019) found that total state revenues from the oil and gas sector decreased from 2012 to 2015. Taking this into account, Middle Eastern countries are trying to implement recent reforms to tax policies.

Oil and gas are significant natural resources for the country of Timor Leste, where the most significant contribution of state revenue to total revenue in the APBN comes from the oil and gas sector, which is 70 percent to 96 percent (period 2013 – 2019, Timor Leste State Budget Report – book 1). Timor Leste's economy is highly dependent on oil and gas. Although Timor Leste has abundant oil resources, these resources have not been able to boost the country's economy to date. Oil and gas are non-renewable resources that can run out at any time. Its fluctuating prices can cause severe problems for the sustainability of the Timor Leste economy.

The International Monetary Fund (2019) stated that Timor Leste's oil resources are expected to end in 2022, and some projections predict that this revenue will be exhausted by 2025.
High dependence on oil and gas resources will cause Timor Leste to experience economic instability in the future. The taxation sector is a sector that must be optimized to reduce the country's dependence on oil and gas. The contribution of taxes to the low state revenue needs to be addressed by carrying out reforms. Mariwan et al. (2005) stated that with the tax reform, the tax performance would be better, so the better tax performance will positively impact government revenues from the tax sector. Several empirical studies evidence this: Kusi (1998) showed that the tax reform process made a significant contribution to the growth of revenue productivity from 1983 to 1993 in Ghana; Muriithi et al. (2003) proved that tax reform has a positive impact on the overall tax structure and individual tax management; (Oriakhi & Ahuru, 2014) show that tax reform by improving the taxation system and reducing the tax burden increases the government's ability to generate more revenue. In addition, the tax reforms in Indonesia in 2008 did not only cover tax rate adjustments. However, they were also complemented by other policies such as modernizing tax administration, simplifying tax payment and reporting systems, and increasing the capacity of tax officials. These measures are intended to increase the tax base and improve overall tax compliance (Amir et al., 2013).

II. Literature Review

Abhimanyu (2003) states that tax reform is a fundamental change in all aspects of taxation, which has three main objectives: a high level of voluntary compliance, high trust in tax administration, and high tax productivity. Often, tax reforms involve changes not only in the tax rate but also in the tax base, and the same thing was argued (Ilzetzki, 2018) that expanding the tax base was at the core of the most successful reforms in recent history.
Several factors that trigger tax reform (Venti et al., 2010) are; (1) changes in the level of economic growth and social life of the community; (2) the previous taxation system could not fully mobilize the participation of all levels of tax subjects in increasing state revenues; (3) the need for increasing and developing state revenues; (4) the need for reform and adjustment of the tax law to provide more legal certainty, simplicity, ease of implementation as well as more fair and equitable distribution; (5) To give confidence to the tax subject to carry out the obligation to fulfill his rights in the field of taxation.
Tax reform aims to create a more straightforward system with lower rates and a broader, more efficient, fair tax base (Jenkins, 1989; Ilzetzki, 2018).
The tax reform that the author intends in this research is to increase tax revenue by expanding the tax base by exploring the potential for taxes and levies, such as adding income taxes and consumption taxes as tax objects. This research also refers to the global tax reform program according to Mayasari (2020), which has three main pillars: tax administration reform, tax policy reform and tax law reform.

2.1 *Tax Administration Reform*

Tax administration reform is an instrument to increase voluntary compliance of taxpayers, increase public trust, and increase the integration of the apparatus. This is supported by Bird et al. (2003). They state that improving tax administration is at the core of the choice of tax structure and increasing taxation in developing and transitional countries.

Developing countries' efforts to improve tax administration have primarily focused on adopting new information technology (IT). The most common use of IT systems in tax administration is to support the core task of tax administration in processing returns and payments and to gather relevant information. Current IT systems continue to provide support enabling tax administrations to shift from heavy manual processing to those that facilitate, monitor and enforce compliance.

Information technology can increase productivity in tax collection and administration (Olatunji, 2017). Administrative modernization is related to the electronic tax system. The electronic tax system aims to accommodate the community's needs and demands to increase the tax system's effectiveness and efficiency. The Indonesian government has carried out three primary forms of the tax administration system modernization: e-registration, e-filling, and e-billing.

Tax e-registration is a system for registering or changing taxpayer data or confirming and revoking the inauguration of a Taxable Entrepreneur through an online system facility that is directly connected to the Directorate General of Taxes. E-filling is a method or process for submitting electronic SPT, carried out online and in real-time via the internet network on the Directorate General of Taxes website. E-billing is a method of paying taxes electronically through a billing system using a billing code (Mayasari, 2020).

Concerning IT, taxpayers, especially corporate taxpayers, also must provide information in the accounting information system. A business's accounting information system collects and records data about activities and transactions; planning; data processing and turn it into information for decision-making for planning, implementation and control activities (Salehi et al., 2010).

Although integration in the accounting and taxation information systems has many advantages, there are also disadvantages when viewed from another point of view. Territoriality and integration are "pushing" in opposite directions. While the territorial system gives foreigners a tax advantage over domestic investment, integration provides the opposite advantage by eliminating benefits concerning exempt or foreign income (Fishbien, 2020).

Based on the concept of good governance, Jubaedah et al. (2008) suggested that there is accountability, information disclosure, and transparency in the implementation of good governance. Following the concept of a deontological theory emphasizes the company's compliance in carrying out its obligations.

2.2. Tax Law Reform

Morris et al. (2009) stated that the main factors influencing the increase in tax revenue performance are changes in legislation, tax administration, and tax expansion. The first thing that must be evaluated in tax law reform is the existing regulations, whether they are appropriate or still lacking, using the Legal Effectiveness Theory and Legal Synchronization Theory. Furthermore, drafting a tax law evaluates the philosophical, sociological and juridical foundations (Mangkuprawira, 2018).

2.3. Tax Policy Reform

Guiding the reform of the taxation system is an obligation of taxation policy; therefore, the tax policy itself must be reformed first (Schurtz, 1986). Tax policies that are useful in the development of the taxation system must be able to abandon the theoretical approach and must adopt a pragmatic approach, where the main principle is the efficient collection of tax revenues (Schurtz, 1986). Blakely (1989) argues that tax policy has always been a significant component of economic development.

2.4. Tax Bureaucracy Reform

Bureaucratic reform is essentially an effort to make reforms and fundamental changes to the government administration system, especially regarding the institutional aspects (organization), management and human resources of the tax apparatus. Various problems/obstacles that cause the government administration system not to work or are not expected to run properly must be reorganized or renewed.

Bureaucratic reform is carried out in order to realize good governance. In other words, bureaucratic reform is a strategic step to building the state apparatus to be more efficient and effective in carrying out the general tasks of government and national development. Another reason for the importance of bureaucratic reform is the rapid progress of science, information and communication technology, as well as changes in the strategic environment that require the government bureaucracy to be reformed and adapted to the dynamics of the demands of society. So it is necessary to immediately take fundamental, comprehensive and systematic steps so that the goals and targets that have been set can be achieved effectively and efficiently.

The results of Tumiwa, Posumah and Kiyai's research (2015) show that implementing bureaucratic reform policies is one of the determinants of locally-generated revenue in Southeast Minahasa Regency. A well-implemented bureaucratic reform, especially in regional finance, is essential for the organization to achieve regional financial performance, mainly locally-generated revenue. Building a professional and impartial bureaucracy may be a good step in building trust in government and fellow citizens (Rothstein, 2000; Rothstein & Stolle, 2008).

III. Profile and Composition of Timor Leste's Tax Sector Revenue

The tax contribution in Timor Leste is an average of 10% and 5% of non-tax state revenues, while the oil and gas sector contributes an average of 85% to Timor Leste's state revenue. The composition of state revenues from the taxation sector can be seen in the table below:

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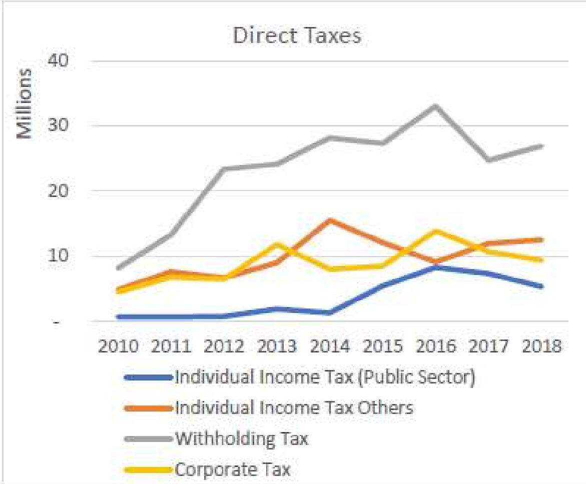

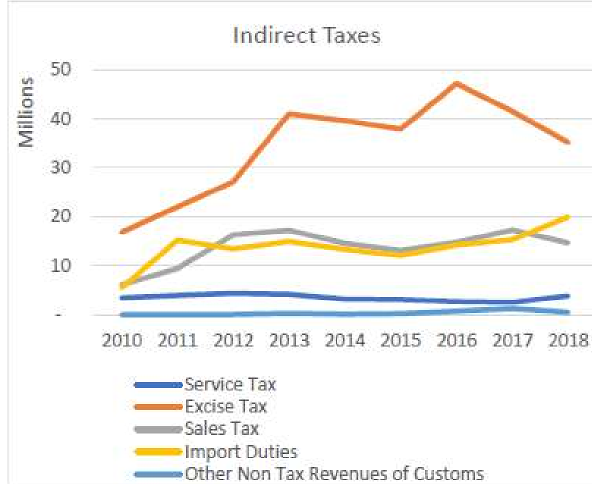

Based on the graph above, taxation in Timor Leste consists of direct and indirect taxes. Direct taxes come from individual income tax (public sector), other individual income tax, withholding tax, and corporate tax. Indirect taxes come from service tax, excise tax, sales tax, import duties and other non-tax revenue of Customs.

Taxation in Timor Leste until 2018 applies to corporate taxpayers generally subject to corporate income tax at a fixed rate of 10%. However, companies operating in the petroleum sector are subject to different tax rules; oil and gas contractors are taxed at a rate of 30% and subcontractors at 6%. Meanwhile, Timor Leste does not impose taxes at the city or regional level on income from corporate taxpayers. Meanwhile, income from employment for individual tax residents is subject to income tax at 10% if the income exceeds USD 500 per month. Non-salary income (individual business) is subject to a 10% rate if it exceeds USD 6,000 per year.

Furthermore, non-resident individuals are subject to an income tax rate of 10%. However, natural persons performing services in connection with petroleum operations will be taxed under the petroleum tax regime. Regarding withholding tax, Timor Leste does not tax dividend income from tax residents, while non-residents are subject to a 10% rate. While income from royalties is taxed at a rate of 10% for both tax residents and non-residents, capital gains received by corporate and individual taxpayers are taxed at a rate of 10%. On the other hand, income in the form of interest, whether paid to residents or non-residents, is not subject to tax. There is also a withholding tax on construction services at a rate of 2%, construction consulting services at 4%, air/sea transportation services at 2.64%, mining and supporting services at 4.5%, and land or building leases at 10%.

Timor Leste applies a sales tax (sales tax) at a rate of 2.5%, import duties at a tariff of 2.5% on imported taxable goods, and an excise tax rate depending on certain goods with specific characteristics. The service tax on hotels, restaurants, and telecommunications is 5% for indirect taxes.

Regarding anti-tax avoidance regulations, Timor Leste does not have specific guidelines for fair prices for transactions with affiliates or other general principles related to transfer pricing rules. Timor Leste also does not have thin capitalization rules, controlled foreign companies or other general anti-avoidance rules (GAAR). Timor Leste entered into a tax treaty with Portugal and a Maritime Boundary Treaty (MBT) with Australia.

This condition has not been able to increase revenue from the tax sector so that it only contributes an average of below 10% (in the period 2013 – 2019) to state revenues, in contrast to other developing countries (most of ASEAN member countries: Indonesia, the Philippines, Singapore, Thailand, Cambodia, Laos and Vietnam and Malaysia), the taxation sector contributes between 70% to 90% of the State Budget (IMF Report, 2019). Efforts to increase domestic resource mobilization remain critical to securing medium-term fiscal sustainability. However, delays in implementing significant fiscal reforms due to ongoing political uncertainty have been a major constraint.

Until now, Sales Tax, Sales Tax on Luxury Goods, Land and Building Tax, Land and Building Acquisition Duty and E-Commerce Tax have not been applied in Timor Leste. These taxes have the potential to be enforced and can increase revenue from the taxation sector in Timor Leste. VAT, for example, has a strategic position and contributes significantly to tax revenues in many countries. VAT is an increasingly important tax in many countries (Bird, 2016). VAT can become a "money machine" if the arrangement is designed in a simple and broad-based manner (Minh Le, 2003). This is supported by Brun (2016), who states that VAT is a robust tax in developing countries. This means that the higher the VAT revenue, the higher the tax revenue.

From the transitional government period until now (approximately 21 years), taxation in Timor Leste has never undergone reform. During this period, there were many changes in various fields, particularly in the economic and development sectors, but changes in the taxation sector did not accompany these changes. Reflecting on the actual condition of the still low level of tax revenue and high dependence on the oil and gas sector, its appropriate for Timor Leste to carry out tax reforms.

IV. The Main Problems that Hinder the Effectiveness of Tax Revenue

Based on the results of previous research, several main problems were found, including:

1. Low Tax Base

The tax base in Timor Leste is still relatively low, namely only eight types of taxes. In comparison, in ASEAN countries such as Indonesia, there are 43 types of tax levies, Myanmar 31 types, the Philippines 14 types, Cambodia 40 types, Vietnam 10 types and Malaysia 8 types. Several types of taxes such as PPN, PPnBM, PBB, BPHTB and e-commerce have not yet been applied even though they have the potential to be collected so that they can increase tax sector revenues. This condition affects the tax revenue, which is still low.

2. Taxpayer awareness and compliance are still low.

Tax awareness is the willingness to fulfill their obligations and contribute funds to implement government functions by paying their tax obligations (Suhardito et al., 1999). The level of awareness of taxpayers affects compliance in paying taxes. In reality, not many people know their tax obligations and understand the essence of the tax itself, but most people carry out their tax obligations only by fulfilling existing provisions. The low tax revenue in Timor Leste is influenced by the low awareness and compliance of taxpayers in carrying out their obligations.

3. Low quality and quantity of fiscus

The tax office has a vital role in tax collection. The tax authorities' low number and weak capacity will impact taxpayers' low compliance in fulfilling their obligations. The number of tax authorities must reach the total number of taxpayers, and the competence of the tax authorities must continue to be updated with training, seminars and workshops. The opposite condition occurs in Timor Leste, where the number of officers has not been able to reach all existing taxpayers, and the competence of the tax authorities is also still weak.

V. Conclusions and Recommendations

The broad goal of tax reform in many low-income countries is to move from dependence on import (and export) taxation to domestic taxation by broadening the tax base - by introducing a value-added tax and broadening the individual income tax base. This goal has been achieved in line with trade liberalization and the need to increase productive efficiency by reducing the level of adequate protection.

The policy advice recommended to countries wishing to reform the tax system places more emphasis on expanding the tax base with the introduction of new taxes or new tariffs on the existing base, more stringent administrative changes to close loopholes that encourage tax avoidance and reducing tax incentives. Other measures include allocating more budgetary resources to revenue authorities, paying higher salaries to tax officials and imposing relatively severe penalties if violations are found (Muriithi et al., 2003).

Factors that are a consistent basis for the successful implementation of reforms include; (1) good leadership and management, (2) the critical need for flexibility in budget and resource management, and (3) the critical need for well-coordinated and effectively used technical and financial assistance.

The tax reform experience to date offers some crucial insights into tax policy design and functional institutional development. A summary of the reforms proposed by Khalilzadeh et al. (1995) is presented as follows:

1. Value Added Tax (VAT) should be the instrument of choice for developing countries considering reforming their sales tax. By the early 1950s, VAT had become a fiscal innovation that swept half the world, including many developing countries. VAT has become the instrument of choice for most developing countries looking to reform their sales tax. It can provide more significant revenue, tax neutrality (economic efficiency) under certain circumstances and, to some extent, vertical equity.
2. The existing tax base should be expanded simultaneously as tax administration reforms are being carried out. Base expansion compatible with some economic objectives can increase income and increase the tax system's simplicity, neutrality and equity.
3. The use of the tax system for specific tax preferences should be carefully evaluated. Using the system to provide tax incentives (tax expenditures) usually results in a severe drain on the national treasury with unexpected profits.
4. Tax reform must take into account the initial conditions at home and abroad. In reforming the tax system, developing countries are severely constrained not only by their institutional arrangements but also by the tax structures of capital-importing countries.

Moreover, the circumstances in many developing countries are usually such that they will experience serious transition difficulties if the tax system is redesigned from scratch. Therefore, developing countries must consider the initial conditions at home and abroad.

5. The credibility of the government, in this case, the taxation authority, is the key to the success of tax reform. A stable tax policy environment encourages businesses to take a long-term perspective in financial and investment decisions. Making tax changes without giving adequate consideration to transitional arrangements can undermine the credibility of tax authorities. Therefore, transitional arrangements require much more careful analysis than has been provided in developing countries. In addition, tax changes should be presented as part of a long-term strategy to improve the public sector environment for the private sector. Tax authorities will gain business confidence if more attention is paid to reform preparation and analysis, prior consultation, providing a reasonable period of adjustment before implementation and ensuring consistency of reform measures.

6. The tax reform process must be well coordinated. Coordinated tax reform offers significant advantages over changing the tax system piecemeal. Coordinated reforms ensure that personal tax changes will be consistent with central objectives. For example, lowering rates without corresponding increases for other taxes, which are generally value-added, can increase the fiscal deficit and exacerbate macroeconomic difficulties. Furthermore, tax reform should be closely integrated with structural adjustment measures to improve the economy's performance in general.

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