

# Legal Reconstruction of Input Tax Credits That Have No Direct Relationship With Business Activities For Legal Certainty of Corporate Taxpayers

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## ABSTRACT

Taxes play a crucial role in national development, both as a source of state revenue and as an instrument for regulating the economy. Value Added Tax (VAT), with its Input Tax credit mechanism against Output Tax, is designed to maintain the principle of neutrality, but in practice it often raises legal issues. Article 9, paragraph 8, letter (b) of the VAT Law, concerning the phrase "directly related to business activities," lacks a clear definition, thus opening room for multiple interpretations. This has given rise to numerous disputes between Corporate Taxpayers and the Directorate General of Taxes (DGT). This research employs a normative legal method with a statutory, conceptual, and case-based approach. The results show that the norm in Article 9 paragraph 8 letter (b) has fundamental weaknesses due to multiple interpretations and implications for legal uncertainty. Legal reconstruction is needed through the development of an explicit negative list, consistent jurisprudence, and modern, digital-based administrative guidelines, so that the national tax system can provide legal certainty, protect taxpayer rights, and strengthen the principle of VAT neutrality.

**Keywords:** *Input Tax; Legal Reconstruction; Legal Certainty*

## INTRODUCTION

Taxes play a crucial role as a source of state revenue and an instrument for regulating economic activity. Tax is a mandatory contribution to the state made by individuals or bodies based on the law, without receiving direct compensation, used for the greatest prosperity of the people. The universal principle of tax law requires that it be based on justice, equality, non-discrimination, and guaranteed legal certainty. Based on Article 23A of the 1945 Constitution, taxes for state purposes are regulated by law. One tax collected under the self-assessment system is Value Added Tax (VAT), imposed on the increase in value of goods or services during their distribution from producer to consumer.

In the VAT collection system, the input tax credit mechanism is a key pillar ensuring the tax system's neutrality towards economic activity. Input tax paid on the acquisition of taxable goods or services by corporate taxpayers should ideally be credited against output tax, so that only the added value is taxed. However, practice shows that crediting does not always proceed smoothly, especially when input tax is deemed to have no direct relationship to business activities, often leading to disputes between taxpayers and the DGT.

In practice, differing interpretations of Article 9 paragraph 8 letter (b) of the VAT Law (as amended by HPP Law No. 7 of 2021) regarding the phrase "directly related to business activities" create legal uncertainty. Two Tax Court decisions illustrate the problem: in Decision No. 111351.16/2011/PP/M.VIIA of 2018, in-kind costs in remote areas were deemed creditable as they were related to business operations; whereas in Decision No. 112741.16/2013/PP/M.XB of 2018, Input Tax on employee housing construction was rejected on the grounds that it served consumptive, not production-related purposes. This inconsistency reveals the absence of objective benchmarks.

Academic literature reinforces this concern. Romlih Marzuki notes that the interpretation of Article 9 paragraph (9) gives rise to recurring disputes due to lack of interpretative guidelines. Untung Sukardji states that legal uncertainty in input tax credits reduces voluntary taxpayer compliance. Gunadi argues that Input Tax credits should provide flexibility as long as the activity supports the business as a whole. The DDTC team (2025) further identified input tax crediting as among the top sources of VAT disputes, as Article 9 paragraph 8 letter (b) is considered ambiguous and difficult to apply consistently.

This uncertainty is contrary to the principles of legality and legal certainty as mandated in Article 28D paragraph (1) of the 1945 Constitution. According to Mardiasmo, reformulating tax regulations must ensure legal certainty as a basis for trust between tax authorities and taxpayers. Philosophically, taxes in a state governed by rule of law are not merely a means of collection, but a manifestation of the social contract between the state and its citizens. According to Jimly Asshiddiqie, the legal system is not only built on formal norms but also on moral values that exist within society. From a sociological perspective, according to Satjipto Rahardjo, the law must be sensitive to changing times and not frozen in textual formalities.

The absence of objective limits for determining direct relationship is also acknowledged by Ahmad Zainal Abidin, who notes that this interpretive gap creates legal uncertainty with potential for unequal taxpayer treatment. Based on the foregoing, this paper investigates the legal reconstruction of Input Tax credits that are not directly related to business activities, as a mechanism to ensure legal certainty for corporate taxpayers.

## **RESEARCH METHODS**

This research employs a normative legal method, which is a scientific procedure to find truth based on the logic of legal science from its normative side. It uses a statutory, conceptual, and case-based approach. Primary legal materials include the VAT Law, the HPP Law, and relevant Tax Court decisions. Secondary legal materials include tax literature, journals, and relevant scientific works. Analysis is conducted deductively through systematic and teleological interpretation to assess the conformity of norms with the principles of legality, justice, and the objectives of the tax system.

## **RESULTS AND DISCUSSION**

### **Legal Arrangement of Input Tax Credits under Article 9 Paragraph (8) Letter (b) of the VAT Law**

Tax collection is the transfer of a portion of the people's income to the government based on enforceable statutory provisions, used to finance government operations for national prosperity. Taxes serve both a budgetary function — filling the state treasury — and a regulatory function as an instrument to achieve goals in economic, monetary, social, and political spheres.

Indonesia's VAT adopts a self-assessment system with a credit method, allowing Input Tax paid on the acquisition of Taxable Goods or Services to be credited against Output Tax. This mechanism aims to avoid overlapping tax collection effects, ensuring VAT remains neutral. Under Law No. 8 of 1983 as amended by Law No. 7 of 2021, Input Tax may be credited against Output Tax within the same tax period, provided a valid tax invoice exists as stipulated in Article 13 of the VAT Law and PMK No. 18/PMK.03/2021.

Article 9 of the VAT Law provides exceptions where Input Tax cannot be credited, including: acquisitions before the entrepreneur is confirmed as a PKP; acquisitions with no direct relationship to business activities; acquisition and maintenance of sedans and station wagons (except merchandise or lease); utilization of intangible BKP or JKP from outside

the Customs Area before confirmation as PKP; acquisitions with non-compliant Tax Invoices; Input Tax from tax assessments; Input Tax not reported in periodic VAT returns found during audit; and acquisition of BKP other than capital goods before production commences.

In addition to formal requirements (a valid tax invoice), there is a material requirement: the acquisition must be directly related to business activities. Based on Article 9 paragraph 8 letter (b), Input Tax on acquisitions not directly related to business activities cannot be credited. "Directly related" is defined as expenses for production, distribution, marketing, and management activities.

The exemption is intended to prevent crediting of consumptive or personal expenses. However, disputes arise because there is no clear delineation between consumptive expenses and those that support the business — for instance, whether employee accommodation, company polyclinics, or in-kind assistance constitutes a "direct connection." Tax auditors tend toward narrow interpretation, recognizing only expenses related to the core production or sale of taxable goods. Taxpayers, conversely, interpret it broadly. This conflict drives tax disputes, as reflected in multiple Tax Court decisions.

Although the HPP Law introduced several reforms — administrative integration, expansion of the tax base, and strengthening of self-assessment — Article 9 paragraph 8 letter (b) was not substantially amended. The ambiguous phrase "direct relationship" remains without further explanation.

Three Tax Court decisions illuminate the interpretive inconsistency. In Decision No. 111351.16/2011/PP/M.VIIA of 2018, in-kind costs in remote areas were deemed creditable because they had a functional relationship with business activities; the panel prioritized substantive evidence. In Decision No. 112741.16/2013/PP/M.XB of 2018, Input Tax on a permanent polyclinic was denied because its use was not directly related to production, distribution, or management, with the panel also clarifying that PMK No. 83/PMK.03/2009 (on benefits in kind in certain areas) applies to income tax, not VAT. In Decision No. 111602.16/2013/PP/M.VIIA of 2018, the appeal was partially granted where some corrected expenditures were proven to have direct operational functions.

Viewed through Adam Smith's Tax Law Theory, this regulation reflects principles of fairness and certainty: taxpayers should clearly understand when input tax is creditable. However, substantive fairness must also be maintained so that the norm does not impose

disproportionate burdens on businesses in regions with special circumstances. Using Gustav Radbruch's Theory of Legal Certainty, Article 9 paragraph 8 letter (b) provides formal certainty, but the values of justice and utility sometimes clash with it. When the Tax Court rejects credit for operational facilities in remote areas, formal certainty is maintained but substantive justice for affected taxpayers is neglected.

Comparing with international practice reveals a stark difference. The EU VAT Directive recognizes input tax on all business expenses except those expressly prohibited, and the European Court of Justice interprets "connection with the business" broadly. Malaysia and Singapore implement negative lists, where only specific expenditures (personal entertainment or private vehicles) are non-creditable. This approach yields greater legal certainty and fewer disputes. Economically, rejection of Input Tax on employee housing or polyclinics raises operational costs, which are then transferred to consumers, reducing export competitiveness and potentially lowering the country's foreign exchange reserves.

### **Legal Reconstruction to Provide Legal Certainty for Corporate Taxpayers**

Legal reconstruction in the taxation sector is an urgent need to achieve legal certainty for corporate taxpayers. Suharsono noted that many Tax Court decisions show interpretive differences between judges and tax authorities regarding transactions giving rise to Input Tax, leaving corporate taxpayers vulnerable to corrections not always based on the principle of justice. Under the self-assessment system, taxpayers are given full authority to calculate, pay, and report their obligations; disharmony often arises with the corrective authority of the tax authorities.

Jatmiko emphasized that the reconstruction of Indonesian tax law must address the principle of equality so that taxpayer rights to input tax credits cannot be disregarded due to administrative issues. Dwiyanti and Musri similarly highlighted that centralization of VAT through the e-invoice system still leaves potential injustice for taxpayers in cross-branch transactions, requiring more flexible regulations to ensure no credit rights are lost due to technical constraints.

The three Tax Court decisions examined in this research demonstrate a lack of uniformity that creates legal uncertainty. In Decisions No. 111351.16/2011/PP/M.VIIIA and No. 112741.16/2013/PP/M.XB, both from 2018, the panel rejected Input Tax credits for employee housing and polyclinic construction as personal expenses. However, in Supreme Court Decision No. 286/B/PK/PJK/2013, the Court granted credit for dormitories and

catering services at mining sites, treating these as operational necessities functionally related to business activities. This inconsistency is particularly detrimental to taxpayers in sectors with special operational needs such as mining, oil and gas, and infrastructure.

Normatively, the HPP Law provides some room for renewal: Article 8A allows the tax base in the form of "other values" as determined by the Minister of Finance, and PMK No. 131 of 2024 Article 3 paragraph (3) and PMK No. 11 of 2025 Article 2 affirm that Input Tax on BKP and JKP used in taxable business activities can be credited. However, the core ambiguity of "direct link" in Article 9 paragraph 8 letter (b) remains unaddressed.

Legal reconstruction must be directed at affirming the "direct link" criterion based on economic function (functional nexus), not merely the form of expenditure. This approach recognizes operational activities that significantly support production — such as work facilities in remote areas, field transportation, or work accommodation — as legitimate bases for Input Tax credits. This is consistent with international precedent, notably CJEU Case C-98/98 *Midland Bank plc*, which recognized expenditures with a direct and immediate link to taxable activities as grounds for crediting rights.

From Adam Smith's Tax Law Theory perspective, this reconstruction aligns with the principles of certainty and equity: legal certainty is achieved through explicit crediting regulations, while justice is realized through proportional tax treatment of real economic activities. From Gustav Radbruch's Legal Certainty Theory, this reconstruction aims to balance the values of certainty, justice, and utility.

Legal reconstruction can be pursued through two main approaches. First, a normative-regulatory approach, whereby the government drafts implementing regulations containing an explicit list of expense types recognized as "directly related to business activities," modeled on the negative list approach in Singapore and Malaysia. Second, a consistent jurisprudential approach, whereby the Supreme Court, in conjunction with the Tax Court, establishes interpretive guidelines to ensure uniform decisions on similar cases.

From a tax administration perspective, legal reform is crucial to reducing disputes. Recurring conflicts over the interpretation of "direct relationship" drain the resources of the DGT and the judiciary, hampering effective tax oversight. With clearer regulations, tax auditors have objective guidelines, subjective interpretations are eliminated, and corporate taxpayers will be more compliant, confident that their rights are protected. This also has direct implications for investment competitiveness: unclear norms increase compliance

costs and reduce investor willingness to invest, while uncredited Input Tax on vital business expenses undermines VAT neutrality and creates market distortions.

Legal reconstruction must also address technological developments and digital tax administration. The widespread adoption of e-invoicing and electronic reporting provides opportunities to increase transparency and legal certainty. However, legal reconstruction should emphasize that minor administrative errors must not deprive taxpayers of substantive rights, as long as underlying transactions are real, legitimate, and business-related — consistent with the substance over form principle applied in many OECD countries.

Concrete steps for legal reconstruction include: (i) issuance of implementing regulation or a Circular Letter (SE DJP) setting parameters of "direct relationship" based on business activity categories and geographic conditions; (ii) establishment by the Supreme Court and the Tax Court of judicial guidance to ensure consistency in input tax credit decisions; (iii) increased integration between the VAT and Income Tax regimes to prevent inconsistent treatment of in-kind benefits in certain regions; and (iv) development of binding advance guidance (tax rulings) to allow taxpayers to request written confirmation before engaging in complex transactions, similar to Singapore's Advance Ruling System.

From the perspective of Satjipto Rahardjo's progressive law, the law must dynamically respond to societal needs and economic developments. Legal reconstruction of Input Tax crediting must therefore be based on the principle of proportionality between the state's interest in maintaining tax revenues and the taxpayer's interest in protecting their rights, ultimately reinforcing voluntary compliance and strengthening the social legitimacy of tax collection.

The success of this reconstruction will be largely determined by the synergy of three elements: clear regulations that provide objective guidelines; adaptive administration that ensures implementation without rigid formalism; and consistent jurisprudence that provides certainty in dispute resolution. Reconstruction must also demand a paradigm shift — from an adversarial approach to a cooperative compliance partnership between tax authorities and taxpayers.

In conclusion, legal reconstruction of Input Tax crediting is not merely a technical-administrative need but a strategic agenda concerning justice, legal certainty, and the sustainability of the national tax system. An ideal reconstruction should prioritize legal

certainty, proportionality, justice, and substance over form, so that expenditures genuinely supporting business continuity are recognized as the basis for Input Tax crediting. Three strategies can be implemented: a normative-regulatory approach through a negative list; a consistent jurisprudential approach through uniform interpretation guidelines; and a modern administrative approach through digitization, simplification, and advance guidance. Such reconstruction is both a constitutional obligation of the state to provide fair legal protection and certainty, and an economic strategy to realize a neutral, efficient, and growth-supporting tax system.

## **CONCLUSION**

Based on the foregoing, two conclusions may be drawn. First, the norm in Article 9 paragraph 8 letter (b) of the VAT Law has fundamental weaknesses because it is open to multiple interpretations. This is evident in Tax Court practice, where the restrictive interpretation of "directly related to business activities" tends to place Corporate Taxpayers at a disadvantage. Productive costs that support business continuity — such as employee housing in remote areas or polyclinic facilities — are rejected as consumptive. This narrow and formalistic interpretation reduces taxpayer rights, erodes the sense of justice, and weakens the basic principle of VAT as a neutral consumption tax.

Second, legal reconstruction of the Input Tax crediting framework is an urgent need in the Indonesian tax system. The provisions of Article 9 paragraph 8 letter (b), which emphasize "direct connection with business activities," have proven open to multiple interpretations and are a major source of tax disputes. Court practice shows that narrow interpretations often harm taxpayers, increase compliance costs, weaken the principle of VAT neutrality, and reduce the investment climate in Indonesia. Legal reconstruction through an explicit negative list, consistent jurisprudence, and modern administrative guidelines is therefore imperative to ensure legal certainty, protect taxpayer rights, and strengthen VAT neutrality in support of Indonesia's investment climate and economic growth.

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