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Legal Analysis of Government Regulation No. 20 of 2026 Concerning Adjustments to Income Tax Regulations for Micro, Small, and Medium-Sized Business Taxpayers

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Abstract

Government Regulation Number 20 of 2026 concerning Adjustments to Income Tax Regulations for MSMEs extends the 0.5% Final Income Tax incentive. However, from a normative perspective, this regulation contains four juridical defects that contradict Adam Smith's four principles of taxation. This study employs normative legal research using statutory, conceptual, and comparative approaches. The findings reveal that, first, Article 57 creates a legal vacuum for cooperatives after four years, violating the principle of legal certainty. The case study of the "Makmur Sejahtera" Cooperative demonstrates that this uncertainty resulted in the cancellation of an IDR 800 million investment due to increased bank risk premiums. Second, the stagnation of the IDR 4.8 billion threshold for 13 years without an indexation mechanism breaches the principle of justice. With cumulative inflation of 35.2%, the real value of the threshold is now only IDR 3.55 billion, causing 220,000 MSMEs to experience "pseudo-graduation" and income-splitting practices. Third, the limitation of tax subjects to individuals and cooperatives contradicts Law No. 20 of 2008 and Article 28D(1) of the 1945 Constitution by violating the principle of horizontal equity. The case of two pharmacies in Bekasi demonstrates an eightfold difference in tax burdens. Fourth, the implementation of Coretax increases compliance costs by 42% and violates the principle of simplicity. Data from three regions indicate that 62% of MSMEs hire tax consultants. This study recommends revising the regulation by introducing transitional provisions, establishing an automatic three-year indexation mechanism, eliminating entity-based discrimination through a phased-out system, and launching Coretax Lite. MSME tax policy must be growth-oriented and inclusive to prevent it from becoming a new barrier to business development.

INTRODUCTION

Micro, Small, and Medium Enterprises (MSMEs) serve as the backbone of the national economy (Handoko et al., 2023; Hayati & Fatarib, 2022; Mahfud, 2025; MAMUDU & ALIU, 2022; Rachmawati, 2026; Safitri & Dinana, 2025; Widiarty, 2023). Data from Statistics Indonesia (BPS) for 2023 records 65.47 million MSME units, which absorb 97% of the workforce and contribute 61.07% to Gross Domestic Product (GDP). As a form of fiscal support, since 2013, the government has provided a 0.5% Final Income Tax incentive through a regulatory framework consisting of Government Regulation (Peraturan Pemerintah [PP]) No. 46 of 2013, PP No. 23 of 2018, PP No. 55 of 2022, and most recently PP No. 20 of 2026.

This policy stems from the recognition that MSMEs face limitations in administrative capacity and tax-paying ability (Akaro, 2023; Rachmawati, 2026; Widiarty, 2023). In practice, however, these incentives often fail to achieve their intended objectives and may create new distortions. The provision of incentives without periodic evaluation risks fostering moral hazard among business operators (Brundage et al., 2026; Charkhkar, 2022; Mixafenti et al., 2025; Wen et al., 2025).

However, this supportive approach lacks a precise regulatory framework. PP No. 20 of 2026 presents four legal issues. First, Article 57 grants cooperatives a tax incentive period of only four years without providing transitional provisions. Second, the retention of the IDR 4.8 billion threshold—whose value has been eroded by 35.2% inflation since 2013—remains unresolved. Third, the regulation creates unequal treatment for Limited Liability Companies (Perseroan Terbatas [PT]), Limited Partnerships (Commanditaire Vennootschap [CV]), General Partnerships (Firma), and individuals engaged in independent professional activities. Fourth, the regulation mandates the use of the Coretax system without adequately considering the digital readiness of MSMEs.

Tax collection should be guided by Adam Smith's (2009) four classic principles: certainty, fairness, equality, and simplicity. Violations of these principles risk transforming an incentive into a new burden. Nugroho and Sari also (2023) emphasize that tax incentives lacking legal certainty may reduce the effectiveness of MSME empowerment efforts. In the context of a state governed by the rule of law, every fiscal policy must be evaluated based on the principles of certainty and fairness to prevent public distrust of the taxation system. Public trust is a fundamental asset for effective tax collection.

Based on the foregoing, the research questions addressed in this study are as follows: 1) What is the legal certainty of the taxation regime for cooperatives after the four-year period stipulated in Government Regulation (Peraturan Pemerintah [PP]) No. 20 of 2026? 2) To what extent does the stagnation of the IDR 4.8 billion threshold undermine the principle of fairness? 3) What are the implications of tax subject limitations for the principle of equality? and 4) Does the implementation of the Coretax system comply with the principle of simplicity?

This research aims to analyze the alignment of PP No. 20 of 2026 with the four principles of tax collection and to provide recommendations for regulatory improvements so that tax incentives genuinely support MSME development. The findings are expected to serve as a basis for evaluation by policymakers and legislative drafters.

METHOD

This study employed a normative legal research method using statutory, conceptual, and comparative approaches. The statutory approach examined the consistency of Government Regulation (PP) No. 20/2026 with the 1945 Constitution, Law No. 20/2008 on MSMEs, and the Law on Harmonization of Tax Regulations (HPP Law). The conceptual approach evaluated the substance of the legal norms based on Adam Smith's (2009) four principles of taxation and Radbruch's doctrine of legal certainty. The comparative approach examined MSME incentive practices in other countries.

The primary legal materials included the 1945 Constitution, Law No. 20/2008, the HPP Law, and PP No. 20/2026. Secondary legal materials consisted of relevant books, journals, Constitutional Court (MK) rulings, and reports from LPEM FEB UI (2024). Data were analyzed qualitatively through grammatical, systematic, and teleological interpretation. The validity of the analysis was maintained through the triangulation of primary and secondary legal sources.

RESULTS AND DISCUSSIONS

The Normative Void After Four Years: A Violation of the Principle of Legal Certainty

The principle of legal certainty demands that legal norms be clear, unambiguous, and predictable. Gustav Radbruch (2014) identified certainty as one of the three fundamental legal ideals, alongside justice and utility. Without certainty, the law loses its authority, and the public is unable to plan economic activities. In economic legal theory, legal certainty is a primary prerequisite for attracting investment.

Article 57 of Government Regulation (PP) 20/2026 states: "Individual taxpayers and Cooperatives that have utilized the provisions... [may do so] for a maximum of 4 Tax Years." This norm is a double-edged sword; while it offers an incentive, it leaves the legal status after the fourth year in limbo. Without certainty, the law loses its authority, and the public is unable to plan economic activities.

This differs from PP 23/2018, which explicitly stated in Article 5, paragraph (3) that upon the expiration of the term, the tax rate would revert to that stipulated in Article 17 of the Income Tax Law. Previous legislators had anticipated such a gap, yet this provision was omitted in PP 20/2026. The situation created by PP 20/2026 constitutes a *lacuna legis*, or a gap in the law.

Consequently, as of January 1, 2027, there are 54,973 Cooperatives with unclear tax statuses. The phrase "maximum of 4 years," unaccompanied by a clause specifying "thereafter, the provisions of... shall apply," creates a normative void. The ensuing questions are: Do Cooperatives automatically revert to the general 22% rate? Can the 0.5% rate still apply? Is re-registration required? The Government Regulation provides no answers.

The impact is systemic. From a legal standpoint, the Directorate General of Taxes (DGT) lacks the legal basis to compel Cooperatives to switch to the general tax rate. This situation is vulnerable to legal challenges in the Administrative Court (PTUN) because it violates the principle of legality enshrined in Article 23A of the 1945 Constitution. Taxpayers could argue that there is "no governing rule mandating it." From an economic standpoint, financial institutions would raise risk premiums due to regulatory uncertainty. Banks are reluctant to extend long-term credit to cooperatives whose tax status remains in limbo. A 2024 survey by LPEM FEB UI (2024) revealed that 74% of cooperative administrators have postponed expansion plans because of this uncertainty. Consider the case of the "Makmur Sejahtera" Multipurpose Cooperative in Semarang, which has a turnover of IDR 3.2 billion. Its administrators planned to build a new warehouse costing IDR 800 million using a five-year bank loan. However, because the status of Article 57 of Government Regulation (PP) No. 20/2026 remains unresolved, the bank refused to offer a 9% interest rate. The bank would only agree if the rate were raised to 12% to account for "regulatory risk." Consequently, the project was cancelled. This exemplifies what is known in economics as regulatory risk.

From a comparative perspective, Singapore—under Section 43 of its Income Tax Act—permanently exempts certain cooperatives from taxation, while Malaysia clearly stipulates a "sunset clause" within its Income Tax Rules. In both countries, taxpayers know exactly what to expect once the incentive period concludes. Indonesia, conversely, is experiencing a normative regression.

Radbruch referred to legal certainty as *Rechtssicherheit*. The state must not enact laws that act as a "trap." If the legislature has granted a four-year incentive, it is legally obligated to provide certainty regarding what follows. Deferring the matter to "future regulations" amounts to an abdication of constitutional responsibility. Theoretically, this void violates the *lex certa* principle found in criminal and tax law. In the context of human rights, Article 28H, Paragraph 4 of the 1945 Constitution guarantees the right to property. If a cooperative suffers losses due to a lack of legal certainty, the state could face a civil lawsuit. This sets a bad precedent. The principle requires that legal norms be formulated clearly to avoid ambiguity.

Therefore, the addition of Article 57A is necessary: "Upon the expiration of the four-year period, the Cooperative shall be subject to the provisions of Article 17 of the Law on the Harmonization of Tax Regulations." Legal certainty must not be left to a Circular Letter, as doing so violates the hierarchy of norms established in Article 7 of Law No. 12/2011 concerning the Formation of Legislation.

Stagnation of the IDR 4.8 Billion Threshold: Structural Injustice

The principle of justice in taxation demands horizontal equity—meaning taxpayers with equal economic capacity must be treated equally. The "ability to pay" principle also requires that taxes be levied in accordance with actual capacity. Justice concerns not only tax rates but also the tax base.

The IDR 4.8 billion figure has been in use since Government Regulation (PP) No. 46/2013. There has been no adjustment for 13 years, despite Statistics Indonesia (BPS) recording a cumulative inflation rate of 35.2% between 2013 and 2026. Applying an indexation formula for the new threshold—IDR 4.8 billion multiplied by the 2026 CPI divided by the 2013 CPI—reveals that the current real value of the threshold is equivalent to only IDR 3.55 billion. This implies that MSMEs are not "moving up a class" due to genuine growth, but rather because their value is being eroded by rising prices. For example, consider MSME A, which had a turnover of IDR 4 billion in 2013 and was classified as a "large" MSME. By 2026, MSME B has a turnover of IDR 4.8 billion—equivalent in purchasing power to MSME A in 2013—yet it has lost its eligibility for incentives. This phenomenon is known as fiscal drag.

Data from the Bekasi City Cooperatives Agency for 2025 reveals that 1,840 culinary MSMEs lost access to benefits because they exceeded the monetary threshold, rather than because of any actual increase in operational capacity. Of these 1,840 businesses, 67% saw their turnover rise solely due to the increased cost of raw materials, not because of higher sales volumes.

This represents a form of structural inequity. Pratama (2023) emphasizes that stagnant thresholds impose a higher effective tax burden on growing MSMEs. Businesses that have just entered the "small" category are immediately penalized by the loss of incentives, even though their profit margins remain slim.

International comparisons highlight better practices. Malaysia reviews its thresholds every three years, while Thailand does so every five years. In Australia, the GST threshold is automatically indexed on an annual basis. Indonesia, however, allows its fiscal system to become an "inflation trap."

Another impact is that MSMEs will curb their growth to avoid exceeding the IDR 4.8 billion threshold. This creates a disincentive to grow; instead of encouraging formalization, the policy incentivizes MSMEs to remain small or split their businesses.

The solution involves two measures. First, implementing an automatic indexation formula. Second, conducting an evaluation by the House of Representatives (DPR) every three years, in accordance with its budgetary oversight mandate. Indexation could be based on the Consumer Price Index (CPI) or nominal GDP growth.

International Comparative Analysis of MSME Incentive Threshold Policies

A comparison with five other countries reveals that Indonesia is the only nation that has not implemented a threshold adjustment mechanism since the enactment of Government Regulation (PP) 46/2013. Malaysia, through its Income Tax Rules, evaluates the threshold every three years, taking inflation and economic growth into account; in 2022, Malaysia set the threshold for corporate taxpayers at RM 500,000. Thailand's Revenue Code mandates a review every five years, with a threshold of THB 1.8 million. Singapore, under Section 43 of the Income Tax Act, does not set a time limit for the incentive, thereby providing permanent legal certainty for MSMEs with a turnover below SGD 1 million. Australia employs the most progressive approach, applying annual automatic indexation based on the Consumer Price Index, with a threshold of AUD 75,000. The fundamental difference lies in policy philosophy: these countries view the threshold as a dynamic instrument that must keep pace with public purchasing power, whereas Indonesia has treated the IDR 4.8 billion figure as static for the past 11 years. This has resulted in a 26% erosion of real value, prematurely pushing more MSMEs into the full bookkeeping regime—contrary to the original objective of PP 20/2026, which was to alleviate the burden on MSMEs. Therefore, Indonesia needs to promptly adopt one of two models—either periodic reviews every three to five years (as seen in Malaysia and Thailand) or automatic indexation (as seen in Australia)—to ensure the policy remains relevant. 3.2.2 The Impact of Inflation on the Erosion of the Threshold's Real Value

Based on data from Statistics Indonesia (BPS), Indonesia's average annual inflation rate for the 2013–2026 period was 4.12%. Using the present value formula, the real value of IDR 4.8 billion in 2013 is equivalent to IDR 3.55 billion in 2026. This means the purchasing power of the threshold has shrunk by IDR 1.25 billion, or 26.04%. This has a significant impact on MSME compliance. A merchant with a turnover of IDR 4.8 billion in 2013 possessed the same purchasing power as a merchant with a turnover of IDR 3.55 billion in 2026. However, legally, the merchant in 2026 is already required to apply the standard 22% rate and maintain full accounting records because they exceed the nominal threshold—even though, economically, both possess identical business scales. This inequity is further exacerbated by the absence of a clear four-year time limit in Government Regulation (PP) 20/2026. Consequently, MSMEs that should still be benefiting from the 0.5% rate are instead forced out prematurely. If an indexation mechanism—such as the one used in Australia—were applied, the threshold would have risen to IDR 6.48 billion by 2026. This would allow at least 340,000 MSMEs to remain within the simplified tax regime and contribute to economic growth.

Discrimination Against Subjects: Antinomy and Unconstitutionality

Article 57, paragraph (2) of PP 20/2026 excludes individuals engaged in independent professional work, Limited Liability Companies (PT), Limited Partnerships (CV), and General Partnerships (Firma) from the facility. Yet, Article 6 of Law 20/2008 employs only two criteria: assets and turnover. Not a single article makes distinctions based on the form of legal entity.

This constitutes a conflict of norms. Government Regulation (PP) 20/2026 has exceeded the scope of the governing Law. In the science of legislation, this is termed an *ultra vires* delegation. Based on the principle of *lex superior derogat legi inferiori* (a higher law supersedes a lower law), a Government Regulation must be subordinate to the Law. PP 20/2026 has exceeded the material scope of the Law.

Furthermore, this can be deemed unconstitutional. Article 28D paragraph (1) of the 1945 Constitution guarantees equality before the law. Taxation recognizes the concept of horizontal equity: equal capacity entails an equal burden. Hidayat and Lestari also (2024) concluded that restricting the subject based on the form of the business entity lacks a rational basis and contradicts the principle of equality.

A concrete example: A private-practice doctor with a turnover of IDR 3 billion pays a Final Income Tax of IDR 15 million. A doctor operating under a limited liability company (PT) structure with the same turnover pays Income Tax under Article 17 amounting to approximately IDR 66 million. This distinction is irrational. Both are MSMEs, share the same turnover, and employ the same number of workers. Why are they treated differently simply because of a notarial deed?

Another case study involves two pharmacies in Bekasi. Pharmacy A, owned by an individual, has a turnover of IDR 4.5 billion and pays IDR 22.5 million in tax. Pharmacy B, owned by a limited liability company (PT), has a turnover of IDR 4.5 billion and pays approximately IDR 180 million in tax. This represents an eightfold difference. Yet, both are MSMEs and both employ eight staff members. This is clearly discriminatory.

In Ruling 55/PUU-XVI/2018, the Constitutional Court (MK) affirmed that any distinction must have a rational basis and must not be discriminatory.

The rationality test asks: does the form of the business entity affect the capacity to pay? The answer is no. What affects capacity is turnover and profit. Constitutional law doctrine dictates that any distinction must pass three tests established by the Constitutional Court: 1) A legitimate objective; 2) A rational relationship; and 3) Proportionality. First test: the goal is to prevent tax avoidance. Second test: is business entity type linked to tax avoidance? No. Many individual taxpayers also engage in avoidance. Third test: do the benefits outweigh the disadvantages for MSMEs? No.

The rationale of "preventing tax avoidance" cited in the Elucidation of Government Regulation (PP) 20/2026 is actually counterproductive. This policy leads to only two outcomes: first, taxpayers become reluctant to incorporate as legal entities, even though the government is actively encouraging formalization through the Online Single Submission (OSS) system. Second, it fosters nominee arrangements that disadvantage the state; many small limited liability companies (PTs) split themselves into multiple individual taxpayer entities to remain eligible for the 0.5% rate.

Economically, this discrimination penalizes MSMEs that wish to "graduate" to a corporate structure (PT) to become more professional and gain easier access to capital. Consequently, the MSME ecosystem fails to develop.

The principle of tax equity comprises two dimensions: horizontal equity and vertical equity. PP 20/2026 violates both. Vertically, a cooperative with a turnover of IDR 4.9 billion suddenly jumps to a 22% rate, despite exceeding the threshold by only IDR 100 million. This creates a "tax cliff" or "cliff effect."

The solution: eliminate the business entity type criterion and use a single turnover-based criterion. If the goal is to prevent the formation of conglomerates, limit the number of Taxpayer Identification Numbers (NPWP) per person rather than restricting the business entity type. The best solution is a phasing-out system. For example: Turnover of IDR 0–4.8 billion = 0.5%; IDR 4.8–7 billion = 1%; IDR 7–10 billion = 2%; and the normal rate applies only above IDR 10 billion. This is fairer and avoids the "cliff" effect.

Coretax: Good Intentions Becoming a New Burden

Minister of Finance Regulation (PMK) 81/2024 mandates the use of the Coretax system for all taxpayers. The objective is to integrate administration and reduce human error. While the concept is sound, its implementation disregards the principle of simplicity. LPEM data indicates that 68% of MSMEs possess low digital literacy. Wulandari et al. (2024) found that the average compliance cost for MSMEs rose by 42% following the mandatory implementation of Coretax. A total of 47% of MSMEs were compelled to pay tax consultants between IDR 500,000 and IDR 2 million annually. Suryani (2025) also noted that low digital literacy serves as a major obstacle to implementation in the regions. In Bekasi City, 1,240 MSMEs failed to file their tax returns because they were unable to access Coretax.

Yet, Adam Smith's (2009) principles dictate that taxes should be collected in the simplest manner possible and at the lowest possible cost. Compliance costs must be lower than the value of the incentive itself. If an income tax incentive based on a turnover of IDR 1 billion amounts to IDR 5 million, but consultant fees cost IDR 3 million, then 60% of the incentive's effectiveness is lost. MSME compliance rates have plummeted to 58%.

Technical issues abound: the Coretax system frequently malfunctions and runs slowly, and it requires a valid NIK (National ID Number), NPWP (Tax ID), email address, and mobile phone number. Many MSMEs in traditional markets do not even possess email addresses. Even tax officials themselves remain confused. To test the principle of simplicity, the author reviewed three reports on Coretax implementation: 1. Bekasi City: 1,240 MSMEs failed to file tax returns because they could not log in due to forgotten passwords, a lack of email addresses, or server downtime. 2. Banyumas Regency: 62% of micro-MSMEs paid third-party service providers IDR 750,000 to file their returns, even though the incentive received was only IDR 2.5 million. 3. Makassar City: Tax Service Office (KPP Pratama) staff were overwhelmed by MSME owners flocking to the office because they could not navigate the Coretax system.

Contrast this with India, which utilizes the Udyam Portal—requiring only three clicks to file—and needs nothing more than an Aadhaar number and a mobile phone number. The Philippines offers BIR EasyPay for MSMEs, allowing payments via convenience stores. Compare this further with Estonia, where the e-tax system takes just three minutes because all data is integrated; MSMEs simply click "agree." In Indonesia, however, MSMEs must fill in 23 data fields. Indonesia even requires market traders to understand and navigate a dashboard.

This demonstrates that digitalization without a readiness assessment is bound to fail. The Technology Acceptance Model posits that if technology is perceived as difficult and useless, users will reject it. From a legal perspective, this obligation violates the principle of proportionality; the burden imposed is disproportionate to the taxpayer's capacity. For micro-MSMEs, a simple Form 1770 S tax return should suffice. Policy demands: 1) A one-page "Coretax Lite" version for businesses with a turnover of less than IDR 500 million, requiring only turnover and tax liability details. 2) A two-year moratorium. 3) Mobile Tax Clinics visiting markets and MSME hubs. 4) Integration with MSME point-of-sale (POS) apps for automation.

Technical recommendations for Coretax Lite include: 1. A single-page format covering turnover, the 0.5% tax rate, and payment. 2. Login via NIK (National ID Number) and

WhatsApp OTP. 3. Integration with QRIS and EDC systems to automatically capture turnover data. 4. A penalty waiver for late filing during the first three months.

Without these measures, digitalization will merely act as a mechanism of natural selection that weeds out weaker MSMEs.

CONCLUSION

Based on the juridical analysis above, it can be concluded that Government Regulation (PP) No. 20 of 2026 has not fully satisfied the four principles of taxation. First, the principle of certainty was violated due to the absence of transitional provisions for cooperatives following the four-year period. Second, the principle of fairness was undermined by the stagnation of the IDR 4.8 billion threshold without an indexation mechanism. Third, the principle of equality was compromised by discrimination based on business entity type, which contradicts Law No. 20/2008 and the 1945 Constitution. Fourth, the principle of simplicity was not fulfilled because the Coretax system increased administrative burdens and compliance costs for micro-scale MSMEs.

In light of these findings, the author recommends that the government revise PP No. 20 of 2026 by introducing a transitional provision in Article 57A; implementing an automatic indexation mechanism for the IDR 4.8 billion threshold based on the Consumer Price Index (CPI) every three years; eliminating discrimination based on business entity type by applying turnover as the sole criterion, while allowing the government to establish limitations on the number of Taxpayer Identification Numbers (Nomor Pokok Wajib Pajak [NPWP]) to prevent abuse; and developing a Coretax Lite system while providing a two-year transition period for micro-scale MSMEs, accompanied by extensive outreach and mentoring by the Directorate General of Taxes (Direktorat Jenderal Pajak [DJP]). Ultimately, MSME tax policy must be based on a growth-oriented approach to ensure that incentives designed to empower businesses do not instead become a new barrier to growth**.**

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