

TAX REFORM IN EFFORTS TO OPTIMIZE REVENUE IN THE TAX SECTOR OF TIMOR LESTE

CARLOS A. BARRETO¹, RETNO MAWARINI SUKMARININGSIH² and
AGUS WIBOWO³

¹PhD Candidate, Faculty of Law, University of 17 Agustus 1945, Indonesia.

^{2,3}Lecturer, Faculty of Law, University of 17 Agustus Semarang, Indonesia.

Abstract

This article is motivated by the idea of implementing tax reform as an effort to optimize Timor Leste's tax revenue, which has historically been dominated by income from oil and gas. Tax sector revenue has thus far only reached approximately 10%, threatening national financing due to fluctuations in global oil prices. This study employs a literature review approach. Data were collected from official reports, financial statements of the Timor Leste Ministry of Finance (Book 1), and from various countries, international organizations such as OECD, World Bank, IMF, UNDP, research institutions, and published research journals. Data analysis was conducted using a comparative approach. The findings indicate that, firstly, the appropriate tax reform strategy to optimize revenue in Timor Leste's tax sector is through legal and policy renewal, making the tax system simpler, more accessible, fair, effective, efficient, and transparent. Secondly, policy reforms that Timor Leste can adopt from other countries to enhance tax revenue include diversifying the types of taxes and broadening the tax base to encompass more economic activities under tax regulations. Thirdly, lessons from successfully reforming countries in reducing dependency on the oil and gas sector—such as the modernization of tax administration utilizing information and communication technology (ICT)—are relevant for Timor Leste. This modernization can be realized through a tax administration platform that makes taxpayers feel that paying taxes is easy, fair, and transparent.

Keywords: Legal Renewal, Tax Diversification, Administrative Modernization.

INTRODUCTION

Tax revenue is one of the essential sources of state income needed to finance development. Since gaining independence in 2002, Timor Leste's tax sector has contributed less than 10% of the total State Budget. Over 90% of national income is derived from non-tax sources, primarily oil and gas (World Bank, 2024), resulting in an state budget structure highly susceptible to fluctuations in global oil prices. When oil prices decline, Timor Leste's capacity to fund development diminishes. Countries heavily dependent on oil, such as Nigeria and Venezuela, have experienced economic instability. Nigeria faced setbacks due to inconsistent tax reforms, where tax regulations favored the central government over regional authorities and lacked taxpayer support (Opeyemi et al., 2022).

Nigeria has experienced hyperinflation and infrastructure deficits (Oziegbe et al., 2024). Similarly, Venezuela's economy, with 60% of revenue from oil, has been unstable, influenced heavily by oil prices (Mu & Hu, 2018). Venezuela suffered hyperinflation reaching 2,950% in 2020 (Mondal & Bahl, 2023). Efforts to curb inflation included increasing tax rates across various taxes (Acevedo et al., 2020), but these measures were too late to prevent the economic crisis. Timor Leste's dependency on oil revenue mirrors that of Nigeria and Venezuela

(Ximenes, 2025). Oil exports have sharply declined from 2008 to 2018, with crude oil exports dropping from 4,988 thousand metric tons in 2008 to 831 thousand metric tons in 2018. The country's economic growth slowed from 5.8% in 2010 to -6.8% in 2020 (Rumbia et al., 2022). Thus, Timor Leste must consider alternative revenue sources, particularly taxation, to sustain development. Tax revenue in Timor Leste accounts for only about 10% of the overall budget, with 90% derived from oil.

The limited tax revenue stems from outdated tax regulations. Law No. 18/2000 on Tax Procedures, which underpins tax administration, is no longer relevant to modern economic dynamics and has yet to effectively promote compliance, efficiency, or transparency in tax collection. Additionally, Law No. 8/2008, establishing a flat 10% proportional tax rate for all taxpayers, is considered unfair as it does not differentiate based on economic capacity, placing equal burdens on both low- and high-income communities. This often leads to tax avoidance if taxpayers perceive the system as unfair (Wulandari, 2017).

The proportional system is often contrasted with a progressive system, which distributes tax burdens fairly according to individual economic capacity (Nasution et al., 2024). The limited tax contribution is also due to the dominance of personal income tax from individuals and corporations. Untapped potential exists in other tax types such as Value-Added Tax (VAT), Luxury Goods Tax, Property Tax, Land and Building Rights Acquisition Tax, environmental taxes, and e-commerce taxes, all of which can significantly increase state revenue.

Tax compliance among taxpayers is influenced by factors including tax administration quality, taxpayer services, and legal enforcement (Suleman, 2019). Furthermore, the current tax administration system, SIGTAS (Standard Integrated Government Tax Administration System), faces various challenges (Santos et al., 2015). SIGTAS is no longer suitable for technological developments and often experiences technical issues that hinder service delivery and enforcement. Modernizing the system is urgent to ensure efficient, transparent, and accountable tax collection, reporting, and oversight.

These issues underscore the necessity for tax reform in Timor Leste. Tax reform is a fundamental process undertaken by the government to transform the tax system comprehensively, including administrative restructuring, regulatory improvements, and expanding the tax base, aligned with economic, social, and political changes (Peter et al., 2025). The goal is to optimize tax revenue and enhance the role of taxes in development, reducing reliance on oil and gas income.

Timor Leste's tax reform must be holistic, encompassing three main aspects: (1) legal and policy renewal; (2) diversification of tax types and broadening the tax base; and (3) modernization of tax administration. These pillars should be integrated into a national strategy for systematic and sustainable tax reform. Tax law comprises rules governing tax collection, triggering events, and the amount of tax imposed (Umar, 2024). Diversification and broadening of the tax base will expand the country's financial resources, enable better development financing and foster social contract strength by making taxation more equitable and transparent. Indonesia's successful implementation of modern tax systems utilizing ICT illustrates the importance of technology

in tax administration. The modernization efforts include taxpayer registration via e-registration, electronic payments (e-payment), electronic reporting (e-reporting, e-SPT), digital document filing (e-filing), and consultation (e-consulting) (Pujiwidodo, 2009). Tax reform should be gradual, supported by broad political participation and public support, as demonstrated in Indonesia (Bawazier, 2011; Mahpudin, 2024; Sinaga et al., 2023), and countries like Norway (Christiansen, 2004; Hemming, 2018), Malaysia (Hingun et al., 2015; Narayan, 1996), Vietnam (Bhattarai et al., 2019; Nguyen et al., 2017), and India (Hoseini & Briand, 2020; Rao, 2018), which have effectively increased tax revenues through reforms. Indonesia's tax reform from 1983 to 1994 doubled tax revenue contribution relative to oil sector revenue (Putri & Najicha, 2021). Malaysia's reform included reducing income and import taxes; the policy aimed to promote indigenous entrepreneurship and economic growth, with corporate and personal income tax rates gradually lowered (Narayan, 1996). Tax diversification, such as delaying VAT implementation until political support was secured, proved effective in Malaysia (Narayan, 1996).

Various theories underpin tax reform analysis in Timor Leste. The socio-economic theory of taxation posits that tax compliance relates to economic structure, ideology, and culture, involving interactions among political institutions, tax systems, and social contracts (Brautigam et al., 2008). The Tax Capacity theory states that a country's ability to mobilize taxes depends on fiscal policy quality, economic structure, and administrative capacity (Bird & Zolt, 2003). Modern Tax Law emphasizes continuous legal updates aligning with economic, social, and political developments, ensuring clarity, fairness, and effectiveness (Tipke & Lang, 2005; World Bank, 2021). Political support and transparency are critical in creating favorable legal frameworks (McLure, 2005).

The Progressive Taxation theory advocates for differentiated treatment of high- and low-income groups, promoting equity. The Tax Morale theory highlights that taxpayers are more compliant when they perceive the system as fair and trustworthy (Torgler, 2007). The aim of tax reform is to maximize revenue efficiency (Mirrlees, 1971), achievable through diversification (Oates, 1972; 1999), which involves expanding revenue sources across various taxes and jurisdictions to reduce dependency on limited sources. In conclusion, Timor Leste's tax reform should involve legitimate political processes with broad participation to foster trust and compliance, based on lessons from successful countries. The reform must include legal updates, diversification, and modernization of tax administration, utilizing ICT to enhance transparency, efficiency, and taxpayer compliance, ultimately improving revenue collection and reducing dependence on oil.

Problem Formulation

Based on the background, this article examines the appropriate tax reform strategies to optimize Timor Leste's tax revenue. Specifically, the study aims to answer three main

Questions

1. What are the appropriate tax reform strategies to optimize revenue in Timor Leste's tax sector?

2. What tax reform policies can Timor Leste adopt to enhance tax revenue?
3. What lessons can be learned from other successful countries in reforming taxes to reduce oil dependency, and how relevant are these lessons for Timor Leste?

Research Methods

This study employs a comparative qualitative approach (Qualitative Comparative Analysis/QCA) developed by Charles Ragin (2017). The comparative approach maps combinations of legal, administrative, and political factors contributing to successful or failed tax reforms. Data collection involves document studies focusing on policy documents, government publications, and international reports from countries with successful tax reform experiences, such as Indonesia, Vietnam, and Rwanda. The analysis compares legal aspects, administrative systems, and fiscal performance, incorporating lessons learned from both successful and unsuccessful cases.

RESEARCH RESULTS AND DISCUSSION

1) Tax Reform in Resource-Rich Countries

Norway and Saudi Arabia exemplify resource-rich countries that successfully reform their tax systems to reduce reliance on oil revenue. Norway utilizes a dual income tax system separating labor and capital taxes, offering incentives for productive sectors (Christiansen, 2004), including simplified regulations for business partnerships (Hemming, 2018). Norway diversified taxes and expanded the base to include VAT, personal and corporate income taxes, financial service taxes, wealth taxes, property taxes, environmental taxes, research and development taxes, and vehicle taxes (Hemming, 2018). These reforms resulted in a stable tax-to-GDP ratio and equitable income distribution (Boadway & Keen, 2010). Norway's economy remains relatively stable, with non-oil income constituting 45% of GDP (Hemming, 2018). Tax audits further increased compliance (Hebous et al., 2023).

Saudi Arabia relies heavily on oil, with about 60% of government revenue from oil. The 2016 slowdown and falling oil prices prompted gradual reforms, including implementing a 5% VAT in 2018 and increasing the rate in 2020 as part of Vision 2030 to diversify the economy (Blazquez et al., 2021). IMF (2022) notes ongoing challenges in compliance, tax literacy, and institutional capacity. Nonetheless, fiscal diversification efforts are gradually improving economic resilience, with recent estimates indicating a 10-60% reduction in vulnerability to oil price shocks (Almutairi et al., 2024).

2) Digital Taxation and Fiscal Inclusion

Digitalization facilitates tax administration, as seen in Brazil and Rwanda. Brazil pioneered e-invoicing and digital tax administration since the early 2000s, replacing paper documents with legally recognized digital equivalents (Melo et al., 2009; Vieira et al., 2019). OECD (2015) reports that real-time VAT monitoring and cross-agency data integration significantly reduce evasion, with Brazil's tax-to-GDP ratio reaching 16.7% in 2024 (De Renzio et al., 2025). Rwanda adopted a digital tax system focusing on improving taxation, simplifying procedures,

and broadening the tax base through platforms like e-Tax, Electronic Billing Machines (EBM), and mobile payments (Gilbert & Bruce, 2025). Rwanda's digital reforms, including registration, e-filing, and fiscal inclusion of micro-entrepreneurs, increased tax-to-GDP ratios from 9% to over 15% in a decade. However, a 2024 report warns that tax burdens on micro-enterprises may hinder competitiveness (UNDP, 2024).

3) Progressive Reforms

Indonesia, Malaysia, and Vietnam, as developing Southeast Asian countries, have undertaken progressive tax reforms. Indonesia's reforms since 1983 include self-assessment, tax amnesty, and digital systems like the Core Tax Administration System, gradually increasing the tax base and revenue (Wibisono, 2020). Indonesia's tax revenue now constitutes about 70% of state income, with progressive rates for high-income individuals (Sinaga et al., 2023). Malaysia's reform involved reducing income taxes and import tariffs, with phased VAT implementation delayed until political support was secured (Narayan, 1996). Malaysia shifted to SST (Sales & Service Tax) in 2018, which, despite lower revenue, is believed to support long-term growth (Jamel et al., 2023). Vietnam has achieved remarkable tax system simplification, expanding the tax base and improving compliance, supported by integrated fiscal policies and efficient electronic tax systems like eTax, which is well-received by the public (Hung et al., 2024). Tax rates for personal income range from 5% to 35%, with a flat 20% for foreigners, and overall tax-to-GDP ratios reached 12.05% (AMRO, 2025).

4) Cases of Tax Reform Failure

Venezuela and Nigeria exemplify fiscal failure due to over-reliance on natural resource revenues and weak institutional governance. Venezuela's heavy dependence on oil exports (96% of exports and over 60% of government revenue in 2015) led to economic crises when oil prices collapsed, with hyperinflation reaching 2,950% in 2020 (Mu & Hu, 2018). Similarly, Nigeria's dependence on oil resulted in a low tax-to-GDP ratio (~6% in 2019), with corruption and weak institutions impeding tax reform (AfDB, 2020). Nigeria's tax system faces challenges such as limited understanding of taxation's role, technological deficiencies, and low taxpayer education (Eze et al., 2016).

5) Future Directions for Timor Leste's Tax Reform

Since 2002, Timor Leste has relied heavily on oil, with over 90% of revenue from this sector, reflecting the Resource Curse Theory (Auty, 1993). To avoid similar pitfalls as Venezuela and Nigeria, Timor Leste must diversify its sources of revenue, particularly through tax reforms. Learning from successful countries, Timor Leste should update tax laws, diversify taxes (e.g., VAT, property, environmental), and broaden the tax base to include online trade. Legal reform should update the outdated Law No. 18/2000 and Law No. 8/2008, which mandates a flat 10% rate, by establishing progressive rates to ensure fairness. The legal framework should also support digital taxation, including regulations for e-commerce, as per recent decrees (DECREE-LAW No. 12/2024). Modernizing tax administration with ICT, such as online registration, reporting, and payment platforms, can increase transparency and compliance (Fjeldstad & Moore, 2008).

Countries like Brazil, Rwanda, and Kenya have successfully increased tax revenues through digital systems, which Timor Leste can emulate. Tax compliance is influenced by perceptions of fairness and the risk of audits (Allingham & Sandmo, 1972). Effective, transparent, and participatory legal reform processes will foster trust, compliance, and sustainable revenue growth.

CONCLUSION

Based on the analysis, it is concluded that Timor Leste's tax reform should focus on legal and policy updates, expanding and diversifying the tax base, and modernizing tax administration through ICT integration. These steps will improve compliance, increase revenue, reduce oil dependence, and support equitable development.

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