



THE SUBSTANCE OVER FORM PRINCIPLE IN INDONESIA: STRENGTHENING GAAR TO COMBAT TAX AVOIDANCE

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Abstract

The substance over form principle has long served as the underlying spirit of Indonesia's income tax framework. However, the absence of clear technical provisions governing its application has created significant challenges, including inconsistent enforcement and divergent interpretations among stakeholders. The amendment of Article 18 of the Income Tax Law through Law Number 7 of 2021 on the Harmonization of Tax Regulations explicitly incorporates this principle and positions it as an instrument to counter tax avoidance under the *General Anti-Avoidance Rule* (GAAR) framework. This study aims to analyze the scope and limitations of applying the *substance over form* principle as a GAAR mechanism in selected jurisdictions, namely Australia, the United States, and South Africa, in order to derive lessons for the development of implementing regulations in Indonesia. The research employs a qualitative approach, combining fieldwork through in-depth interviews with 8 key informants (tax authority, fiscal policy office, tax practitioners, tax judge, academics) and a comprehensive literature review. The findings demonstrate that each reference country adopts distinct approaches in operationalizing the principle as GAAR. Therefore, establishing clear economic substance parameters is essential to enhance legal certainty for taxpayers and ensure consistent enforcement by tax authorities. Such parameters include the existence of genuine cash flows, business rationality beyond tax motives, prevention of tax base erosion, avoidance of cross-border profit shifting, and consideration of transaction timing and contractual arrangements. Moreover, the complexity of GAAR implementation requires the normative role of judges in applying purposive and objective interpretation. Potential increases in tax disputes may be mitigated through the establishment of a GAAR oversight committee.

Keywords: Tax policy, Certainty, GAAR, Substance over form

INTRODUCTION

In 2019, it was estimated that countries worldwide experienced a loss of approximately USD 0.6 trillion in tax revenues due to tax abuse (Chiari, 2024). This information subsequently increased to USD 1 trillion in 2022 and is projected to rise over the next decade to an estimated USD 4.8 trillion annually (Alstadsæter et al., 2024); (Cobham et al., 2023). As a developing country, Indonesia has also been significantly affected by this phenomenon. It also is found that Indonesia ranked 11th globally in cases of tax abuse in the form of tax avoidance. Furthermore, tax avoidance has been identified as one of the contributing factors to Indonesia's persistently low tax revenue performance (Sulistiyanti & Nugraha, 2019).

To address this issue, Indonesia has introduced several domestic anti-avoidance instruments under Article 18 of the Income Tax Law, including the Debt-to-Equity Ratio Rule, the Controlled Foreign Company Rule, the Arm's Length Principle, and regulations concerning Special Purpose Companies, which are categorized as Specific Anti-Avoidance Rules (SAAR). However, (Haryanti et al., 2020) it also is highlighted that loopholes remain within Indonesia's SAAR framework, thereby limiting its effectiveness. Consistent with this finding, Latuny (2017) argues that SAAR alone has not been sufficient to resolve tax avoidance practices due to the absence of a comprehensive General Anti-Avoidance Rule (GAAR).

Following the latest amendment of the Income Tax Law under Law Number 7 of 2021 on the Harmonization of Tax Regulations ("UU HPP"), GAAR provisions may be identified within the explanatory memorandum to Article 18, indicating that the Government is empowered to prevent tax avoidance arrangements that contravene the substance over form principle. This mandate was further reaffirmed under Government Regulation Number 55 of 2022, particularly Articles 32 and 44. Nevertheless, implementing provisions governing GAAR enforcement have yet to be issued.



The substance over form principle is widely recognized as a key tool in combating tax avoidance across jurisdictions. It enables tax authorities to disregard the formal legal structure of a transaction and instead assess its underlying economic reality in order to prevent artificial arrangements designed to circumvent taxation. Despite its widespread adoption, there remains no universal consensus regarding the definition of “substance over form” or the threshold for establishing “economic substance.” As a result, certain jurisdictions, such as China, have encountered inconsistencies in its application (Zhu & Peng, 2023) .

The application of the substance over form doctrine as a tax policy instrument must remain consistent with fundamental principles of taxation, particularly the principle of legal certainty. Legal certainty requires clarity, precision, and consistency in the formulation and interpretation of legal rules (Hart, 1965). However, the absence of explicit criteria for assessing economic substance within Indonesia’s General Anti-Avoidance Rule (GAAR) framework has raised concerns among stakeholders regarding potential uncertainty in its implementation. Previous studies highlight that Indonesia’s GAAR, which is currently formulated in broad and normative terms, requires more detailed implementing regulations—either through Government Regulations or Minister of Finance Regulations—to ensure consistent interpretation and application by both tax authorities and taxpayers (Royani & Yulianti, 2024).

Despite these concerns, limited scholarly attention has been devoted to systematically examining how clearer economic substance standards have been operationalized in other jurisdictions and what lessons can be drawn for Indonesia. Countries such as Australia, the United States, and South Africa have developed more explicit economic substance tests within their GAAR regimes, offering potentially valuable comparative insights. Therefore, this study seeks to address this gap by analyzing the scope and limitations of substance over form testing under GAAR provisions in these jurisdictions and by evaluating Indonesia’s current GAAR framework to derive policy-relevant lessons for future regulatory development.

LITERATURE REVIEW

According to Johansson et al., (2016), the instruments used to address tax avoidance practices are generally categorized into two main forms; Specific Anti-Avoidance Rules (SAAR) and General Anti-Avoidance Rules (GAAR).

Specific Anti-Avoidance Rules (SAAR)

SAAR are defined as a set of anti-avoidance provisions that regulate in detail the specific boundaries of arrangements considered to contravene tax legislation (Johansson et al., 2016). SAAR consist of targeted rules designed to directly address particular forms of tax avoidance that are explicitly identified, including measures aimed at preventing the abuse of transfer pricing, limiting thin capitalization practices, countering the misuse of controlled foreign companies, and restricting the exploitation of tax haven jurisdictions (Hutagaol, 2010).

- a) Preventing the abuse of transfer pricing; SAAR provisions on transfer pricing are specifically developed to combat tax avoidance practices carried out through the manipulation of transfer prices or transactions with affiliated entities that are not conducted in accordance with the arm’s length principle.
- b) Preventing thin capitalization; Thin capitalization refers to the excessive recognition of debt beyond what is acceptable under tax regulations (Ostwal & Vijayaraghavan, 2010). SAAR aimed at preventing thin capitalization seek to limit the deduction of disproportionate interest expenses claimed by taxpayers, which may otherwise reduce the amount of tax liability properly due.
- c) Preventing the misuse of controlled foreign companies (CFCs); Rules addressing the abuse of controlled foreign companies are intended to prevent taxpayers from using artificial corporate structures in foreign jurisdictions as a mechanism for tax avoidance.



- d) Preventing the exploitation of tax haven jurisdictions; Tax haven jurisdictions refer to countries that offer preferential tax regimes or substantial tax relief and are therefore frequently utilized by taxpayers to facilitate tax avoidance arrangements (Ostwal & Vijayaraghavan, 2010).

General Anti-Avoidance Rules (GAAR)

GAAR is designed to prevent transactions undertaken solely for the purpose of tax avoidance or arrangements lacking genuine business substance, which are not addressed under specific anti-avoidance provisions, or to counter emerging tax avoidance practices for which no explicit rules have yet been established (Ismah & Ningrum, 2020). Given the limited scope of schemes that can be effectively covered by SAAR, GAAR is therefore required to address tax avoidance more comprehensively and effectively (Nyberg-Andersson, 2018).

Johansson et al., (2016) define GAAR as a set of anti-avoidance rules that focus on the substance of transactions, arrangements, or schemes without prescribing in detail the specific circumstances that fall within its scope, and that restrict or deny tax benefits where the underlying economic substance is inadequate. Similarly, Whait, in his study explains that GAAR is intended to address more sophisticated tax avoidance schemes (Whait, 2012). Christophe Waerzeggers and Cory Hillier, in the IMF Technical Note on tax law, further describe GAAR as a measure of last resort employed by tax authorities to combat avoidance practices that cannot be captured by SAAR (Waerzeggers & Hillier, 2017).

According to Sadiq & Krever (2020), although GAAR is designed in various forms, it may generally be classified into four categories. The first category, referred to as the “actions and benefits” model, consists of rules that allow tax authorities to identify transactions or series of transactions whose purpose or effect is to obtain a tax benefit, and subsequently to recalculate the taxpayer’s liability based on a hypothetical transaction that the authorities consider would have been undertaken in the absence of the tax-driven arrangement. This model focuses on the actions taken and the tax benefit realized without necessarily requiring an explicit determination of economic substance.

The second category comprises GAAR provisions that have a legislative basis but are sometimes shaped through judicial practice. This model mandates that tax law be interpreted and applied based on the economic substance of a transaction or series of transactions rather than its formal legal structure. Such a GAAR typically enables tax authorities to reassess taxpayers by reference to a hypothetical legal transaction that better reflects the underlying economic reality.

The third category is described as judicial GAAR, which emerges from courts’ adoption of broad anti-abuse doctrines. Krever notes that the Czech Republic is an example of a jurisdiction applying GAAR primarily through relevant judicial decisions. The fourth category is the “abuse of law” model, which applies where taxpayers employ artificial schemes, or legally valid arrangements yet contravene the intent and purpose of tax legislation (Sadiq & Krever, 2020). Krever’s view is consistent with that of Prebble (2017), who similarly classify GAAR into four types, as follows; (1) rules that identify one or more related transactions undertaken with the intent or purpose of generating a tax benefit, and that reassess the taxpayer’s liability based on a notional alternative transaction that would most likely have been adopted but for the tax-efficient choice (2) rules that allow the reassessment of tax liability based on a hypothetical transaction reflecting the underlying economic substance, thereby suggesting that tax law should be interpreted and applied in accordance with transactions possessing genuine economic substance (3) judicially developed GAAR, grounded in the broad abuse of law doctrine (4) GAAR targeting abuse of law, which applies where artificial schemes or legally valid arrangements are used in a manner that frustrates the purpose of tax legislation.



Although jurisdictions adopt different GAAR designs, there is a shared understanding regarding the circumstances in which GAAR may be invoked, namely when three fundamental elements are satisfied. John Tretola, in his article *Trending Towards Convergence*, explains that for GAAR to apply, it must first be demonstrated that the taxpayer has entered into one or more transactions, schemes, or arrangements. Second, a specific tax benefit must have arisen in connection with that scheme or arrangement. Finally, viewed objectively, the taxpayer must have entered into the scheme primarily, or at least not merely incidentally, for the purpose of avoiding tax (J. Tretola, 2017). Consistent with this view, Titus (2019) identifies the three essential GAAR elements as the existence of a scheme, the presence of a tax benefit, and the taxpayer's purpose. Where these elements indicate conduct contrary to the intent of tax legislation, GAAR may be applied.

Firstly, scheme or arrangement Titus (2019) emphasizes that GAAR must clearly define an "arrangement" in order to determine whether it applies to a single transaction or an entire series of transactions. Secondly, tax benefit. GAAR must specify the nature of the tax benefit arising from the arrangement. Titus (2019) notes that such benefits may include the avoidance, reduction, or deferral of tax liability. Thirdly, purpose; as Titus (2019) explains that an avoidance arrangement exists where one of the main purposes of the arrangement, determined at the time the agreement was entered into, is to obtain a tax benefit. An arrangement is presumed to have been designed for such purpose unless the taxpayer can demonstrate, on reasonable grounds and based on relevant facts and circumstances, that obtaining the tax benefit was not one of the main purposes.

Referring to Suryani & Devos (2016), five principles related to GAAR elements may be identified (a) scope of GAAR – GAAR should allow aggregation of transactions covering the entire arrangement or series, (b) purpose Test – The taxpayer's purpose is central in determining whether a transaction is aggressive, (c) power of Reconstruction – GAAR should empower tax authorities to propose alternative tax outcomes, exercised with fairness and consistency, (d) administration of GAAR – A committee should determine whether cases fall within GAAR, potentially comprising tax officials and external experts, (e.) burden of Proof – Debate remains as to whether the burden lies with tax authorities or requires transparent evidence from taxpayers.

Substance Over Form

One of the principles applied in financial accounting is the principle of substance over form, which means that the substance reflected in financial statements represents the factual reality of transactions or events that actually occur, whereas the form reflects the circumstances as viewed from a legal perspective. In the formulation of accounting standards, greater emphasis is placed on substance or economic meaning rather than juridical interpretation (Ramakrishna, 2018). This approach is consistent with concepts commonly adopted in taxation provisions in many jurisdictions, including Indonesia.

Referring to Hutchison (2014), the principle of substance over form is a general legal theory associated with the courts' scrutiny of the name or label attributed to a transaction that is false, simulated, or disguised to reveal the true nature of the transaction. Consequently, this theory is applied when there are attempts to conceal dishonesty through transactions structured to mislead tax authorities (Hutchison, 2014).

Valderrama (2021) argue that the substance over form principle consists of two components: the labelling principle and the simulation principle. The labelling principle states that parties acting in good faith and without intent to deceive may attach an inaccurate label to a transaction, either mistakenly or negligently. In contrast, the simulation principle is associated with parties engaging in sham transactions, indicating bad faith in disguising the true character of a transaction in order to avoid the application of tax law (Ndlovu, 2021).



According to (Hacker, (2019). in ‘Substance Over Form’: Has the Pendulum Swung Too Far?, the doctrine of substance over form operates at four levels: (1) content over name; (2) legal substance over factual appearance; (3) economic substance over legal form; and (4) substantivism over (doctrinal) formalism (Hacker, 2019). The first level, content over name, concerns scenarios in which private parties enter into a particular transaction and designate it by a certain name, while the law examines its true nature and determines that it differs from the label assigned by the parties.

The second level overlaps with the first and third, namely legal substance over factual appearance, whereby the law may sometimes interpret transactions or relationships differently from what might be expected based on their factual manifestation. Hacker (2019) illustrates this with a simple example: although a man, a woman, and a child may have lived happily together for many years, this does not legally render them husband and wife or parent and child.

The third level of the doctrine is economic substance over legal form, in which a particular legal structure is formally recognized, but for specific purposes and valid reasons, the legal form is disregarded in favor of a non-technical economic perspective. This third level constitutes the core of the substance over form doctrine as conventionally understood in the business context.

Economic substance over legal form is a concept introduced in United States tax law and subsequently adopted in many jurisdictions. The Finance Senate (2007) explains that economic substance exists only if: (1) the transaction meaningfully changes the taxpayer’s economic position; and (2) the taxpayer has a substantial purpose for entering into the transaction. The United Nations further notes that indicators of little or no economic substance include the absence of pre-tax profit and limited or no risk of loss; the involvement of tax-indifferent parties; and the lack of any change in the financial position of the parties (Arnold, 2017).

To better understand the doctrine of economic substance, reference may be made to the example provided by Nyberg-Andersson (2018) regarding the decision in *Knetsch v. United States* (1960). In that case, the taxpayer claimed an interest expense deduction arising from the purchase of a non-recourse life insurance policy. Upon investigation, it was found that the insurance returns were lower than the interest costs incurred, and thus the transaction was deemed to lack economic substance because it did not produce a rational change in the taxpayer’s financial position. The absence of economic substance caused the transaction to be classified as one undertaken to obtain tax benefits and, therefore, as a form of tax avoidance.

The fourth level of the doctrine is substantivism over (doctrinal) formalism. This concept relates to the manner in which legal scholars analyze, discuss, and even “discover” or “develop” the law. Substantivism is more closely aligned with interest jurisprudence, whereas formalism corresponds more to conceptual jurisprudence.

Research by Chkhaidze (2021) finds that when tax authorities reclassify transactions, the burden of proof should rest with the tax authorities themselves, thereby establishing a framework for such authorities. Furthermore, it is essential for tax authorities to consider all relevant factors, and each case must be examined individually. Normal business practices should be studied and compared with the disputed transaction, and only after all factors have been thoroughly assessed can a conclusion be reached as to whether the legal form may be altered based on substance (Chkhaidze, 2021). Chkhaidze considers this to represent the minimum standard that must be satisfied in reclassifying a transaction according to its substance and form.

Ostwal & Vijayaraghavan (2010) explain that the principle of substance over form manifests in several other related forms, as follows; (1) Legal versus Economic Substance. This principle applies in situations where, due to the legal form adopted for a transaction, the



taxpayer possesses real economic control over taxable income without incurring the corresponding tax liability. (2) Sham Transaction. A sham transaction essentially conceals the true nature or reality of a transaction that exists only in form. In short, the legal form is preserved, but the underlying substance lacks legal reality. The application of this principle can be observed in the dispute *Knetsch v. United States*, 364 U.S. 361 (1960). In that case, the taxpayer borrowed funds at an interest rate of 3.5% in order to obtain a return of only 2.5% from an annuity investment issued by an insurance company. The investment income was subject to tax at the lower capital gains rate, while the interest payments were fully deductible as an expense. The United States Supreme Court held that the transaction constituted a sham and therefore disallowed the deduction of the interest paid on the loan (Supreme Court, 1960). (3) Doctrine of the Label. This principle is applied when a taxpayer uses an incorrect label or designation to classify or characterize a transaction or relationship for tax purposes. Ostwal and Vijayaraghavan (2010) provide an example of this principle in *Ridge Securities v. IRC*, U.K. 44 T.C. 373 (1962), in which the Court rejected an arrangement described as a loan transaction involving interest exceeding 400% per annum (4) Step Transaction. In a “step transaction,” intermediate steps within a prearranged series of transactions, although bona fide in isolation, may be disregarded, and multiple related transactions may be treated as a single composite transaction. Conversely, a single transaction may be fragmented into several distinct steps in order to determine its tax consequences.

An illustrative case involving step transactions is *W.T. Ramsay Ltd v. Inland Revenue Commissioner*, 54 T.C. 101 (U.K.) (1981). In that dispute, the taxpayer realized a substantial capital gain from the sale of farmland. To offset this gain, W.T. Ramsay undertook a series of separate share and loan transactions that generated non-taxable gains and fully allowable losses. Taken as a whole, these multi-step transactions were circular and self-cancelling. As a result, the taxpayer began and ended in the same financial position while still claiming tax losses. The Court therefore refused to recognize the claimed losses as fiscal losses, reasoning that the taxpayer had not suffered any genuine economic loss. This decision established what is known as the “Ramsay Doctrine,” or the fiscal loss doctrine (House of Lords, 1981).

METHODS

The research approach employed in this study is a qualitative research approach. According to Creswell & Creswell (2018), qualitative research is an approach used to explore and understand the meanings that individuals or groups attribute to a social or human problem. The qualitative research process involves emerging questions and procedures, data that are typically collected in the participants’ natural settings, inductive data analysis that moves from specific observations to broader generalizations, and the researcher’s interpretation of the meaning of the data Creswell & Creswell (2018).

Referring to (Creswell, n.d.), qualitative research is grounded in the natural setting as a holistic entity, relies on humans as the primary research instrument, employs qualitative methods, and applies inductive data analysis. Its objectives are directed toward the development of fundamental theories and it is descriptive in nature. Qualitative research emphasizes the process rather than the outcomes, maintains a defined focus of inquiry, adopts specific criteria for examining data validity, utilizes a flexible and evolving research design, and produces findings that are agreed upon by both the researcher and the research participants.

Based on the above explanation, this qualitative approach aims to understand the scope and limitations of the application of the substance over form principle as a General Anti-Avoidance Rule (GAAR) in Indonesia. Theoretical perspectives on tax policy will also be employed as a reference framework in order to generate findings that are beneficial for both the government and taxpayers.



Data were collected through a literature review and in-depth interviews with 8 key informants. The interviewees consisted of representatives from the Fiscal Policy Office, the Directorate General of Taxes, tax court judges, tax practitioners, and academic

RESULT AND DISCUSSION

Scope and Limitations of the Application of the Substance Over Form Test under GAAR Provisions in Australia, the United States, and South Africa

1. Australia

Provisions regarding the GAAR in Australia can be found in Part IVA of the Income Tax Assessment Act (ITAA), as outlined below.

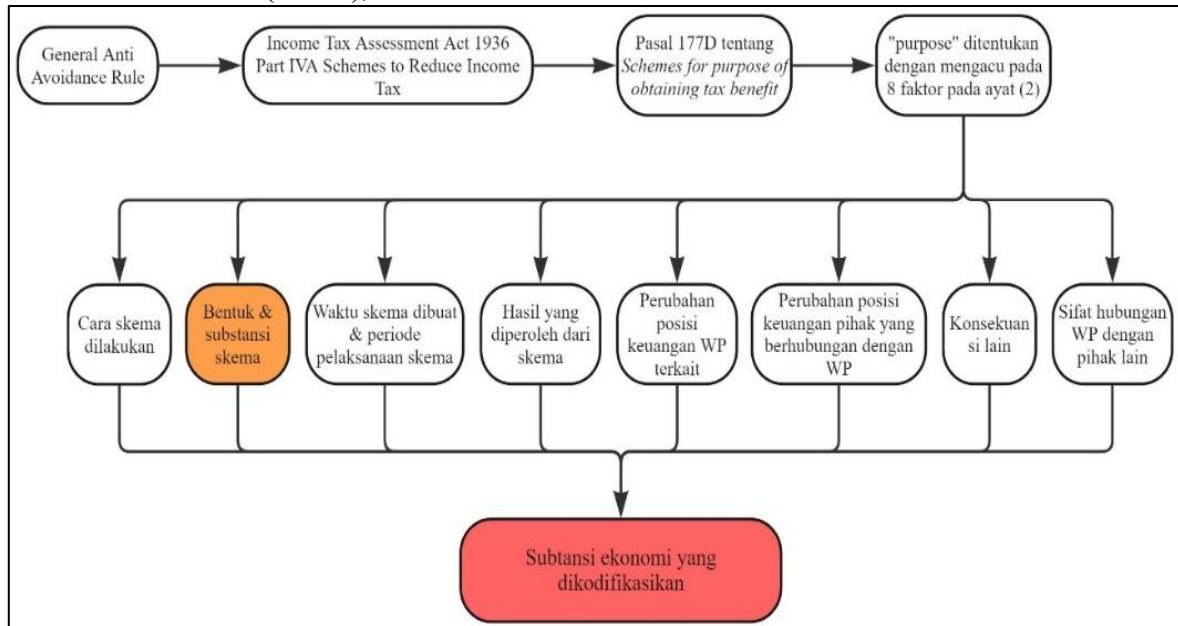


Figure 1. The Position of Substance Over Form pada ITAA Australia

Source: Income Tax Assessment Act 1936 (processed by authors)

As illustrated in the figure above, the substance over form principle is embedded in section 177D(2) of the ITAA and is applied as one of the factors in determining whether a taxpayer entered into a scheme for the dominant purpose of obtaining a tax benefit. At the same time, these eight factors are described by Li and Hwong (2020) as a form of codified economic substance. In other words, section 177D(2) represents an incorporation of the economic substance doctrine into statutory law.

PS LA 2005/24 categorizes these eight factors into three groups. The first three factors are referred to as “how the scheme was entered into or carried out,” the next four factors are termed “the effects of the scheme,” and the final factor concerns “the nature of the connection between the taxpayer and other parties.” The Australian Taxation Office (ATO) emphasizes that the first factor enables the identification of contrivance through a counterfactual inquiry. According to Cooper (2011), in order for Part IVA to effectively address evolving tax avoidance schemes, the use of a counterfactual approach is essential; however, such an inquiry is inherently speculative and subjective (Cooper, 2011).

Tretola (2020) argues that the combination of these three factors reflects a balanced and structured form of assessment. Nevertheless, this does not imply that the remaining factors will be disregarded if the initial factors indicate that the scheme was implemented in a “normal” manner. This was underscored in *Federal Commissioner of Taxation v Hart* [2004] HCA 26, where it was stated that “manner is not determinative; all eight factors must be considered” (Australian Taxation Office, 2005).



The next group concerns “the effects of the scheme.” PS LA 2005/24 stresses that this category requires consideration of the tax outcome, financial changes, and other consequences of the scheme for the taxpayer and related parties. These factors are significant because they demonstrate the concrete effects of the arrangement and assist in determining whether the tax benefit constituted the dominant purpose. The ATO further notes that where, overall, there is no practical change in the total financial position of the parties involved, this strengthens the conclusion that the dominant purpose was to obtain a tax benefit (Australian Taxation Office, 2005).

The Australian government’s efforts to limit the application of GAAR can be observed in a number of disputes. One such example is *Minerva Financial Group Pty Ltd v FC of T* (2024), in which the judge declined to uphold the Commissioner’s determination on the basis that the dominant purpose must be assessed objectively, by examining what actually occurred and evaluating the reasons why it occurred in light of the surrounding context and circumstances. Although the taxpayer’s scheme resulted in a lower tax burden than the alternative scheme identified by the Commissioner, it could not automatically be concluded that the taxpayer’s dominant purpose was to obtain a tax benefit. A similar view is expressed by Darussalam (2023), who emphasizes that GAAR should not be directed at bona fide transactions—namely, transactions that simultaneously serve business, commercial, and tax purposes.

Furthermore, constraints on the application of GAAR in Australia are also implemented through oversight by a committee known as “The Panel.” The objectives of The Panel are reflected in its role as set out in PS LA 2005/24, namely: (1) to provide expert and independent advice to ATO decision-makers regarding the application of GAAR; (2) to ensure that GAAR is applied only after careful consideration and based on facts presented by both ATO staff and taxpayers; (3) to promote consistency and independence in GAAR determinations, thereby enhancing public confidence in the tax administration process; and (4) to serve as a mechanism of oversight by senior public officials in the application of GAAR, ensuring that decisions are more defensible and equitable.

However, The Panel’s decisions are not legally binding, and its role is purely consultative. As noted by Justice G.T. Pagone of the Supreme Court of Victoria at the GAAR Conference in London in 2012, practitioners hold differing views regarding The Panel. Some practitioners enthusiastically support the submission of cases to The Panel for review, whereas others regard it as a waste of time, money, and resources, and as a potential forensic disadvantage (Pagone, 2012).

2. United States

The United States does not have a statutory legal basis that can be categorized as a General Anti-Avoidance Rule (GAAR) comparable to that adopted in Australia. Instead, efforts to combat tax avoidance are carried out through the application of judicially developed anti-avoidance doctrines by the courts, commonly referred to as judicial GAAR (Sadiq & Krever, 2020). An overview of this approach is presented below.

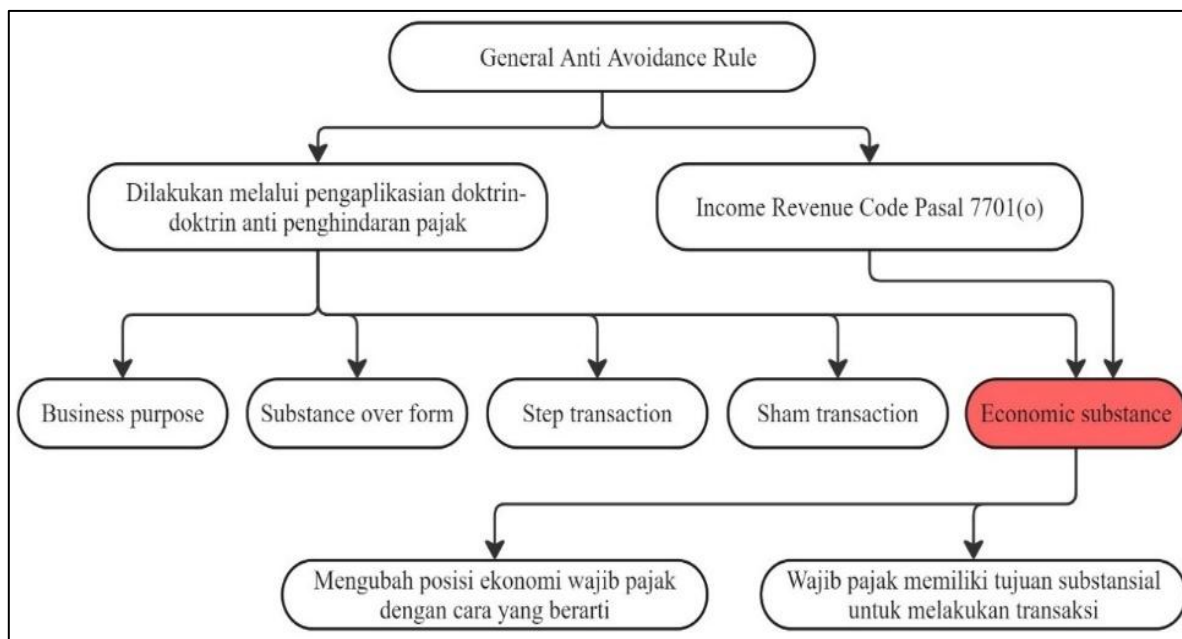


Figure 2. The Position of the Economic Substance Doctrine in the United States
Source: Internal Revenue Code Section 7701(o) (processed by authors)

The principle of substance over form originated in the dispute *Gregory v. Helvering* (1935) and was subsequently expanded in *Knetsch v. United States* (1960), thereby evolving into the economic substance doctrine, which was further conceptualized in *Frank Lyon Co. v. United States* (1978). In general, substance over form is applied by the Internal Revenue Service (IRS) and the courts when there is suspicion of structural manipulation designed to exploit loopholes in tax legislation. In *Gregory v. Helvering* (1935), the Court held that while taxpayers are entitled to arrange their affairs minimize tax liabilities, such arrangements must not contravene the intent and purpose of the statute.

Following its development through judicial decisions, the economic substance doctrine was codified in 2010 through section 7701(o) of the Internal Revenue Code (IRC). Under this provision, where the economic substance doctrine is relevant, two cumulative requirements must be satisfied for economic substance to exist: (1) the transaction must result in a meaningful change in the taxpayer's economic position; and (2) the taxpayer must have a substantial business purpose for entering into the transaction. Although the provision does not expressly specify the circumstances in which the doctrine should be applied, it continues to serve as a key instrument in addressing tax avoidance, accompanied by penalty provisions imposing sanctions of 20 percent or 40 percent of the underpaid tax attributable to transactions lacking economic substance.

The decision to codify the economic substance criteria was driven by a fundamental concern regarding inconsistent judicial approaches to the application of the doctrine in the United States (Nyberg-Andersson, 2018). Some courts had previously held that the requirements of a meaningful change in economic position and a substantial business purpose must be satisfied cumulatively, while others considered that fulfillment of either requirement alone was sufficient to establish economic substance (Giordano, 2017). The enactment of section 7701(o) clarified that both requirements must be met cumulatively, thereby enhancing legal certainty for taxpayers and promoting greater consistency in its application by tax authorities and the judiciary.

Nevertheless, section 7701(o) has been subject to criticism for failing to delineate clearly the circumstances under which the doctrine is applicable (Nyberg-Andersson, 2018). One such critique emerged in *Liberty Global Inc. v. United States* (2023), where Liberty Global



Inc. argued that the phrase “In the case of any transaction to which the economic substance doctrine is relevant...” implied that not all transactions are subject to the doctrine, and that courts must first assess the relevance of applying the economic substance test to the transaction in question. The Court rejected this argument, holding that the phrase does not constitute a procedural barrier to the application of the economic substance test, but rather acknowledges that the doctrine does not apply universally to every transaction.

3. South Africa

Similar to Australia, South Africa has a statutory legal framework governing the application of a General Anti-Avoidance Rule (GAAR) to address tax avoidance practices. Under the Income Tax Act (ITA), this framework is referred to as “impermissible tax avoidance.” An overview of this regime is presented below.

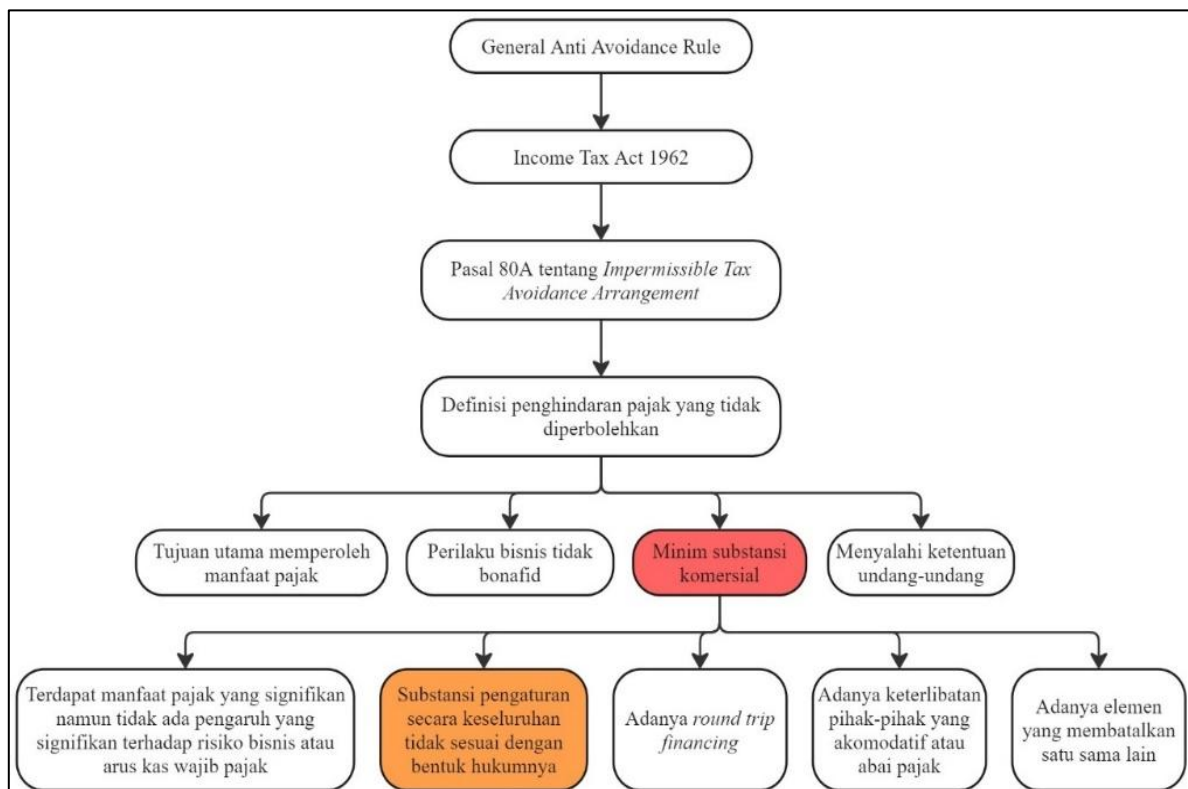


Figure 3. The Position of Commercial Substance in South Africa

Source: Income Tax Act, 1962 as Amended on 2006 (processed by authors)

Prior to the 2006 amendments, only two criteria were used to determine the existence of tax avoidance in South Africa, namely: (i) whether a transaction, operation, or scheme was carried out in a manner not normally employed in comparable transactions, operations, or schemes; and (ii) whether it created rights or obligations that would not normally arise between parties dealing at arm’s length in comparable arrangements.

According to the Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 published by the South African Revenue Service (SARS) in 2005, the amendments were introduced due to the extensive exploitation of loopholes by taxpayers to circumvent the provision. Taxpayers consistently argued that the transactions, operations, or schemes they undertook were commercially reasonable, thereby making it difficult for the tax authority to prove otherwise (South African Revenue Service, 2005).

Following the amendment, five criteria indicating a lack of commercial substance were introduced under section 80C of the Income Tax Act and are referred to as tainted elements. Ngcobo (2023) explains that section 80C(1) constitutes a presumption test, establishing a



general rule for determining whether an avoidance arrangement lacks commercial substance, while section 80C(2) constitutes an indicative test, providing a non-exhaustive list of characteristics that serve as indicators of insufficient commercial substance.

The principle of substance over form is explicitly reflected in section 80C(2)(a). Consistent with Ngcobo’s (2023) analysis, substance over form therefore operates as a non-exclusive characteristic indicating a lack of commercial substance. This implies that if a taxpayer fails to satisfy this principle, the arrangement may be regarded as lacking sufficient commercial substance. The relevant provision of the ITA states that an arrangement will be regarded as lacking commercial substance where the legal substance or legal effect of the arrangement differs from the legal form of the steps undertaken. Accordingly, South Africa’s GAAR adopts an approach that emphasizes the economic reality of a transaction rather than its formal legal structure.

In contrast to Australia and the United States, South Africa’s income tax legislation expressly incorporates safe harbor provisions under section 80E(3). As indicated in section 80C(2), the presence of an accommodating or tax-indifferent party, as regulated under section 80E, constitutes one of the criteria for identifying an arrangement lacking commercial substance. The first safe harbor provides that an exemption applies where the income or profits derived by the relevant party have already been subjected to income tax in another jurisdiction at a rate that is, in aggregate, at least two-thirds of the tax that would have been payable under South African income tax law. For example, with a South African corporate income tax rate of 28 percent, the cumulative tax paid in the foreign jurisdiction must be at least 18.67 percent.

The second safe harbor provides that an exemption applies where the relevant party is actively engaged in substantial trading activities related to the avoidance arrangement for a minimum period of 18 months. Such activities must be conducted through a place of business or specific physical facilities that satisfy the definition of a foreign business establishment under section 9D(1) of the ITA, as if the entity were a controlled foreign company operating outside South Africa. The 18-month duration requirement indicates that the activity must be continuous and genuine, rather than temporary or artificially constructed, in order to demonstrate that the arrangement possesses economic substance.

Based on the comparative analysis of the three jurisdictions discussed above, the application of the substance over form or economic substance principle as a GAAR in Australia, the United States, and South Africa may be summarized as presented in the following table.

Table 1. Summary of the Scope and Limitations of the Application of the Substance Over Form Principle as GAAR in Australia, the United States, and South Africa

Aspect	Australia	South Africa	United States
Legal Framework	Part IVA dari Income Tax Assessment Act 1936	Sections 80A–80L of Income Tax Act 1962	Judicial doctrine and IRC Section 7701(o)
Role of the Substance Over Form or Economic Substance Principle	Operates indirectly through the primary purpose test.	Applied explicitly under section 80C as an indicator of impermissible tax avoidance.	Applied as a judicial doctrine and constitutes a core requirement of a transaction under section 7701(o).
Exceptions or Safe Harbors	No statutory safe harbor; application depends on the discretion of the Australian Taxation Office (ATO) and judicial interpretation.	Statutory safe harbor provisions are provided under section 80E(3).	No statutory safe harbor; application depends on the discretion of the Internal Revenue Service (IRS) and judicial interpretation.
Administrative Oversight	A GAAR Panel composed of ATO officials and external experts is established.	No dedicated panel-based administrative oversight mechanism.	No dedicated panel-based administrative oversight mechanism.



Aspect	Australia	South Africa	United States
Limitations on Applicatio	<p>a. The principle is limited to assessing the taxpayer's purpose of tax avoidance.</p> <p>b. Courts avoid recharacterizing transactions that have a genuine commercial purpose, even where tax benefits are present.</p> <p>c. The establishment of a tax benefit requires a counterfactual analysis.</p>	<p>The safe harbor under section 80E(3) protects entities with substantial business operations, such that GAAR does not target transactions undertaken for legitimate commercial purposes, even where tax benefits arise.</p>	<p>Courts limit the application of the doctrine to transactions that lack any significant economic effect other than the generation of tax savings.</p>

Source: Income Tax Assessment Act 1936; Income Tax Act, 1962 as Amanded on 2006; Internal Revenue Code Section 7701(o) (processed by author)

Regulatory Analysis of GAAR in Indonesia and Lessons Learned from GAAR Frameworks in Australia, the United States, and South Africa

1. Balancing the Substance Over Form Principle as a GAAR

As articulated by Mansury (2002), tax policy may be designed to respond to societal developments by aiming to prevent tax avoidance, tax evasion, and tax abuse. Nevertheless, legal certainty remains a fundamental pillar that must be accommodated for a tax policy to be considered sound. This view was consistently affirmed by all informants in the in-depth interviews, who agreed that the adoption of the substance over form principle as a General Anti-Avoidance Rule (GAAR) represents a positive initiative by the tax authority. However, its application must be carefully calibrated so as not to give rise to an excessive number of disputes between the tax authority and taxpayers.

The placement of the GAAR clause within the explanatory memorandum of the Harmonization of Tax Regulations Law (UU HPP) has also drawn attention from various stakeholders, as such placement is arguably inconsistent with the legislative drafting framework stipulated under Law No. 12 of 2011, as amended by Law No. 13 of 2022. The explanatory section of a statute cannot serve as a legal basis for the issuance of further implementing regulations. This defect in the hierarchy of legislation grants taxpayers the right to seek judicial review before the Constitutional Court and may therefore constitute a barrier to the effective enforcement of GAAR by the tax authority.

Notwithstanding these concerns, informant from the Directorate General of Taxes (DGT), expressed the view that, in terms of substance, the clause is sufficient to function as a legal umbrella enabling the tax authority to address tax avoidance practices that cannot yet be captured by Specific Anti-Avoidance Rules (SAAR). Moreover, the substance over form principle is not the only principle that may operate as a GAAR. This is evidenced by the experience of the United States, where other principles or doctrines—such as the business purpose doctrine, step transaction doctrine, and sham transaction doctrine—have also been employed to address tax avoidance. Nevertheless, it is important for Indonesia to adopt a principle that is relatively simple, easily understood, and readily applicable. With reference to Australia, the United States, and South Africa, it is evident that the substance over form principle may be implemented as a GAAR through a variety of approaches. A comparison between the approaches adopted in these three reference jurisdictions and that of Indonesia is presented in Table 2 below.



Tabel 2. Approaches to the Use of the Substance Over Form Principle in GAAR

Indonesia	Australia	United States	South Africa
GAAR is regulated under the Explanatory Memorandum to Article 18 of the Income Tax Law (UU PPh) and Articles 32 and 44 of Government Regulation No. 55 of 2022.	GAAR is regulated under Part IVA of the Income Tax Assessment Act 1936.	GAAR is not expressly regulated in statutory legislation; however, the economic substance doctrine is codified under Section 7701(o) of the Internal Revenue Code (IRC).	GAAR is regulated under Sections 80A–80L of the Income Tax Act 1962.
No explicit definition of economic substance is provided.	No explicit definition of economic substance is provided.	Economic substance is defined in statutory law and further interpreted through judicial decisions.	Economic substance is defined in statutory law.
There are no further provisions specifying the criteria or conditions for satisfying economic substance.	The determination of economic substance is conducted through an assessment of eight criteria: (1) the manner in which the scheme is carried out; (2) the form and substance of the scheme; (3) the timing of the scheme and the period during which it is implemented; (4) the results obtained from the scheme; (5) changes in the taxpayer's financial position; (6) changes in the financial position of parties related to the taxpayer; (7) other consequences arising from the scheme; and (8) the nature of the relationship between the taxpayer and other parties.	Economic substance is deemed to exist where: (1) the transaction results in a meaningful change in the taxpayer's economic position; and (2) the taxpayer has a substantial purpose for entering into the transaction.	Economic substance is deemed to exist where: (1) there is a significant change in the taxpayer's business risk or cash flows, rather than merely a significant tax benefit; (2) the substance of the transaction is consistent with its legal form; (3) no round financing is involved; (4) there is no involvement of accommodating or tax-indifferent parties (subject to the safe harbor provided in Table 5); and (5) there are no self-cancelling or offsetting elements within the arrangement.

Source: Income Tax Assessment Act 1936; Income Tax Act, 1962 as Amended on 2006; Internal Revenue Code Section 7701(o)

Based on the field study conducted, all informants emphasized the importance of adopting a balanced approach to preventing abuse while ensuring legal certainty. International Tax Policy Analyst at the Fiscal Policy Agency (BKF), stated that the principle may strengthen efforts to prevent tax avoidance but simultaneously warned of the potential for abuse by tax authorities. Accordingly, clear limitations on authority and well-defined procedures are required. Other informants expressed the view that GAAR may lose its “general” character if it is regulated in excessive detail.

Referring to Soemiro's (1988) theory of legal certainty, a tax policy must provide a clear and unequivocal delineation of its legal subject matter or object in order to minimize divergent interpretations by different parties. Where a regulation contains specific elements and



characteristics, clear definitions are required to ensure that the intended meaning is adequately articulated (Soemitro, 1988). In the context of GAAR, the findings of Fernandes and Sadiq (2016) demonstrate that an effective GAAR must provide clear definitions of its key concepts, including, inter alia, the definition of economic substance. This indicates that although GAAR is inherently characterized by its “general” nature, a clear articulation of the parameters of economic substance remains necessary, particularly given that the historical application of the substance over form principle has revealed numerous weaknesses.

Referring to the views of informants representing tax consultant interest, the assessment of the economic substance of a transaction may be conducted by considering several factors, such as the contractual arrangements between the parties, the existence of actual cash flows, the timing of the transaction, and its business rationality. Further, it is also expressed a similar view, noting that where a taxpayer is able to demonstrate the existence of economic benefits other than tax advantages arising from a scheme, the transaction may be regarded as having economic substance. Furthermore, the representative of tax court suggested aligning the assessment with globally applied practices, particularly those relating to base erosion and profit shifting (BEPS). Where it can be clearly demonstrated that base erosion or profit shifting to another jurisdiction has occurred, the transaction should be considered to lack economic substance and thus constitute tax avoidance. It is also further highlighted the importance of alignment with the standards used in assessing the arm’s length nature of related-party transactions, including indicators such as the presence of sustained losses.

2. Consequences of Applying the Substance Over Form Principle as a GAAR

In the context of GAAR, Fernandes and Sadiq (2016) find that legal provisions must be interpreted purposively and objectively in order for GAAR to operate effectively and fairly. Their study explains that the interpretation of legal provisions should be undertaken with due regard to the underlying legislative intent in a prudent manner. This indicates that judges continue to play a crucial role in interpreting the substance over form principle as a GAAR to ensure its effective and equitable application. However, where the scope and limits of the use of substance over form or the definition of economic substance are not clearly articulated, its application will become excessively dependent on judicial interpretation, effectively replicating the situation that existed prior to the inclusion of the substance over form clause in the Harmonization of Tax Regulations Law (UU HPP).

Unlike the United States, Indonesia adheres to a civil law system and therefore does not recognize binding jurisprudence. Jurisprudence—also referred to as case law or judge-made law—constitutes a legal product with binding force and may serve as a source of law (Simanjuntak, 2018). Consequently, in the absence of binding jurisprudence in Indonesia, judicial decisions cannot be relied upon as precedents for resolving future disputes involving similar cases. Accordingly, where there is neither a clear definition of economic substance nor the possibility of binding jurisprudence, there exists a risk of inconsistent and repetitive judicial outcomes.

Given that judicial decisions are, inter alia, based on evidentiary assessment, another issue accompanying the application of the substance over form principle as a GAAR concerns the burden of proof. This issue is also highlighted by Suryani & Devos (2016) in “The Proposed Design of an Indonesian General Anti-Avoidance Rule,” who identify the burden of proof as a recurring challenge in the implementation of GAAR across jurisdictions, thus necessitating careful consideration.

Chkhaidze (2021) in “Changing the Classification of a Business Transaction Based on Its Form and Substance in Tax Law Relations,” emphasizes that tax authorities must evaluate all relevant facts and circumstances when reclassifying a transaction, with the burden of proof resting on the authorities to justify the decision taken. Accordingly, the Directorate General of



Taxes (DGT) must be able to substantiate its determinations by demonstrating indicative factors pointing toward tax avoidance.

Consistent with Chkhaidze's (2021) findings, it is also stated that where the DGT alleges the existence of tax avoidance, one method of proof may involve comparing the tax benefits obtained under the taxpayer's scheme with those that would have arisen under an alternative scheme deemed appropriate by the authority. This approach mirrors the counterfactual analysis applied in Australia; however, such an approach is subject to inherent limitations, as identified by Cooper (2011), who notes that counterfactual analysis is intrinsically speculative and subjective.

The representative from tax court offered a more balanced perspective by emphasizing that taxpayers bear an obligation to substantiate their tax calculations in accordance with applicable legal provisions. Nevertheless, he further explained that in GAAR cases, the burden of proof may shift depending on the specific context of the case. This illustrates that the allocation of the burden of proof under GAAR remains a grey area requiring further regulatory clarification. In the absence of clear rules, there is a heightened risk of increased disputes, whether due to taxpayers perceiving unfair treatment or tax authorities encountering difficulties in consistently substantiating their assertions.

3. Administrative Provisions for the Substance Over Form Principle as a GAAR

Administrative provisions constitute a critical aspect of GAAR implementation Suryani & Devos (2016). In their research, it finds that GAAR administration should include a "panel" composed of experts from the DGT and/or external specialists to determine whether a case is appropriate for GAAR application, thereby ensuring the quality of decisions rendered. This approach is consistent with the use of "The Panel" in Australia. However, the absence of legally binding force attached to the panel's decisions has raised concerns among various stakeholders (Pagone, 2012).

Nevertheless, CIAT (2022) explain that a GAAR panel may be established as a means of enhancing legal certainty for taxpayers, as assessments regarding the appropriateness of GAAR adjustments are conducted by experts operating outside the direct authority of the tax administration. This structure can help ensure independence in decision-making and result in more neutral outcomes. Accordingly, the establishment of an independent supervisory committee may serve as an appropriate administrative mechanism to ensure consistent GAAR application, provided that its decisions are endowed with legally binding authority.

CONCLUSION

Based on the research conducted, it can be concluded. First, in Australia, substance over form testing is conducted to determine the taxpayer's dominant purpose through eight factors that include a counterfactual review of how the scheme is implemented and the economic effects generated by the scheme. There are no explicit statutory limitations governing its application; however, case law involving GAAR reflects a prohibition on tax authorities and courts from recharacterizing transactions that, although motivated by tax benefits, are supported by legitimate commercial purposes. In addition, the application of GAAR by the tax authority is subject to oversight by The Panel. Second, by contrast, the United States does not prescribe a specific methodology for conducting substance over form testing, but it explicitly defines economic substance as the existence of a meaningful change in the taxpayer's economic position and a substantial purpose for entering into the transaction. There are no written statutory limitations on its application, and its enforcement relies heavily on judicial interpretation. Third, similar to the approach adopted by the United States, South Africa does not regulate the method by which substance over form testing is to be conducted; however, it explicitly defines economic substance as including a significant change in the taxpayer's



business risk or cash flows, consistency between the substance of the transaction and its legal form, the absence of round financing, the absence of accommodating or tax-indifferent parties, and the absence of self-cancelling or offsetting elements. A statutory limitation on its application is provided under Section 80E(3) of the Income Tax Act, which functions as a safe harbor for parties that may otherwise be classified as accommodating or tax-indifferent parties.

Drawing on the experience of the three reference jurisdictions, the following lessons may be derived for the implementation of GAAR in Indonesia. First, in formulating GAAR implementing regulations, a clear articulation of the parameters of economic substance is essential to provide legal certainty to taxpayers and to ensure consistent enforcement by the tax authority. Economic substance should encompass the existence of genuine cash flows, business rationality independent of tax benefits, the absence of base erosion, the absence of profit shifting to other jurisdictions, as well as consideration of the timing of transactions and the contractual arrangements between the parties involved. Second, the complexity of GAAR implementation necessitates a normative role for judges in conducting purposive and objective interpretation. This judicial role becomes increasingly significant where the definition of economic substance is not clearly articulated in the legislation. Third, with respect to the administrative framework governing GAAR, two approaches may be considered. First, the establishment of a supervisory committee overseeing GAAR implementation, similar to Australia's The Panel, but with legally binding authority over its decisions, such that disputes may not be brought before the Tax Court where no GAAR violation is found. Second, the reinstatement of Quality Assurance provisions in accordance with Minister of Finance Regulation No. 17/PMK.03/2013, so that the review of decisions issued by the Directorate General of Taxes also encompasses substantive aspects.

Based on the foregoing analysis, the following recommendations are proposed. First, the Government should clearly define the conditions that reflect the existence of economic substance. Given that Article 44 paragraph (1) letter b of Government Regulation No. 55 of 2022 regulates activities carried out by taxpayers that fall within the scope of tax avoidance, the definition of economic substance may be incorporated into that provision in future Minister of Finance Regulations. Second, with respect to quality assurance mechanisms or the protection of taxpayers' rights under Article 44 paragraph (1) letters d and e of Government Regulation No. 55 of 2022, the Government may consider establishing an oversight committee for GAAR implementation that operates independently from the tax authority, or reinstating Quality Assurance provisions that include substantive review of decisions issued by the Directorate General of Taxes.

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