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Interest-to-EBITDA Rules as an Anti-Thin Capitalization Measure in Indonesia: Policy Trade-offs, Drivers, and Implementation Risks

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Abstract

Indonesia introduced an interest-to-EBITDA ratio as a potential interest limitation rule through the Income Tax Law, as amended by the Law on Harmonization of Tax Regulations, and Government Regulation No. 55 of 2022. At the time the underlying research was conducted, however, the technical implementing regulation had not yet been issued. This study compared the interest-to-EBITDA ratio and the debt-to-equity ratio (DER) as anti-thin capitalization measures based on the principles of sufficiency and productivity, identified the factors underlying Indonesia's adoption of the interest-to-EBITDA approach, and examined potential implementation challenges for the tax authority. This qualitative descriptive study drew on documentary research and nine in-depth interviews involving ten policymakers, tax administrators, academics, and practitioners conducted from May to June 2023. The findings showed that neither approach was uniformly superior. In terms of sufficiency, the interest-to-EBITDA ratio was better able to limit opportunities for tax avoidance but could restrict genuine business activities when earnings were low for reasons beyond taxpayers' control. The DER approach was more predictable and better able to accommodate ordinary business financing; however, its balance-sheet variables could be manipulated, and Indonesia's 4:1 threshold was considered overly permissive. In terms of productivity, the interest-to-EBITDA approach provided greater financing neutrality, whereas the DER approach was more familiar and easier for taxpayers to comply with. Indonesia's adoption of the interest-to-EBITDA approach was driven by OECD BEPS Action 4, the global shift toward earnings-stripping rules, and perceived weaknesses in the DER framework. Key implementation risks included higher compliance and administrative costs, interest-rate volatility, disputes involving the substance-over-form principle, and differences between commercial and tax EBITDA. The study recommended calibrated limitation ratios, relief mechanisms based on average EBITDA, clear fiscal adjustments, and a sector-sensitive hybrid approach.

INTRODUCTION

The unequal tax treatment of debt and equity creates a structural debt bias (Apeti, 2023; Cao & Whyte, 2023; Gschossmann et al., 2026; Li, 2024; Muchhala, 2022). Interest expenses are generally deductible in calculating taxable income, whereas distributions on equity are not. This asymmetry can influence firms' financing decisions and, within multinational groups, may facilitate the allocation of debt and related interest deductions to higher-tax jurisdictions (Ali et al., 2022; Thayyib, 2025; Zawisza et al., 2024). Thin capitalization rules are intended to constrain excessive debt financing without preventing businesses from obtaining genuine funding required for investment and operations (Brown et al., 2012; OECD, 2015, 2016).

Indonesia historically addressed thin capitalization through a fixed debt-to-equity ratio (DER). Article 18(1) of the Income Tax Law authorized the Minister of Finance to determine an acceptable ratio between debt and equity. Minister of Finance Regulation No. 169/PMK.010/2015 subsequently established a maximum DER of 4:1 for tax purposes. The fifth amendment to the Income Tax Law, enacted through Law No. 7 of 2021 on the Harmonization of Tax Regulations, broadened the legal basis for limiting borrowing-cost deductions. Its elucidation referred not only to the DER but also to a specified percentage of borrowing costs relative to earnings before interest, taxes, depreciation, and amortization (EBITDA), as well as other possible methods. Government Regulation No. 55 of 2022 retained these alternatives and delegated the technical provisions to a ministerial regulation. At the time this research was conducted, those technical implementing rules had not yet been issued (Bromo et al., 2025; Fimbo et al., 2024; Nasir et al., 2025; Safie & Khairil, 2025; Simabura et al., 2023).

The policy change was significant because the two approaches rely on different proxies. The DER limits the amount of debt relative to equity reported on the statement of financial position. By contrast, an interest-to-EBITDA rule limits deductible net interest expense by reference to earnings and therefore focuses more directly on the relationship between financing costs and economic activity. OECD BEPS Action 4 recommends a fixed-ratio earnings-stripping rule, generally within a corridor of 10%–30% of EBITDA, which may be supplemented by a group-ratio rule and targeted provisions (OECD, 2015, 2016). However, an international recommendation does not, by itself, establish that the approach is equally suitable for all Indonesian businesses. Industries differ in leverage, profit margins, investment cycles, and reliance on external financing. A rule that is effective in limiting base erosion may also deny deductions to commercially genuine businesses during downturns, start-up periods, or other periods of temporarily depressed earnings.

This article addresses three research questions. First, how do the interest-to-EBITDA ratio and the DER compare as anti-thin capitalization measures when assessed according to the principles of sufficiency and productivity? Second, what factors explain the introduction of the interest-to-EBITDA approach in Indonesia? Third, what implementation challenges may confront the Indonesian tax authority? Accordingly, this study aimed to compare the interest-to-EBITDA ratio and the DER as anti-thin capitalization measures under the principles of sufficiency and productivity, identify the factors underlying Indonesia's adoption of the interest-to-EBITDA approach, and examine potential implementation challenges for the tax authority. The benefits of this research are threefold. Theoretically, the study contributes to the tax policy and thin capitalization literature by comparing two distinct interest-limitation approaches in the context of a developing country, thereby extending understanding of BEPS Action 4 implementation beyond OECD member jurisdictions. Practically, the study provides evidence-based recommendations for Indonesian policymakers in designing technical implementing regulations that balance tax-base protection with proportionality for businesses, including calibrated ratios, appropriate relief mechanisms, and clear tax adjustments. Methodologically, the study demonstrates the value of qualitative policy analysis in tax research, particularly for examining policy trade-offs and implementation risks that may not be fully captured through quantitative analysis. The analysis maintains the central proposition of the underlying study: the two approaches involve distinct advantages and disadvantages, and the policy choice should not be reduced to the assertion that either method is categorically superior.

METHOD

This study employed a qualitative descriptive policy-analysis design to compare two interest-limitation approaches, examine the rationale underlying their adoption, and assess anticipated administrative challenges. The evidence base consisted of legislation, OECD materials, scholarly literature, policy documents, and semi-structured in-depth interviews.

Informants were selected purposively based on their direct knowledge of tax policy formulation, tax administration, academia, accounting, law, or tax practice. Ten individuals participated in nine interview sessions, comprising one member of Commission XI of the Indonesian House of Representatives involved in deliberating the Law on Harmonization of Tax Regulations, one Fiscal Policy Agency official, two Directorate General of Taxes analysts interviewed jointly, four academics specializing in taxation, accounting, and law, and two tax practitioners. Interviews were conducted in May and June 2023 using a semi-structured interview guide with follow-up questions tailored to each informant's area of expertise.

Data analysis involved transcription, repeated reading, coding, categorization according to the research questions and the sufficiency-productivity framework, formulation of preliminary findings, and comparison across interview and documentary sources. Source triangulation was used to assess consistency and divergence among policymakers, tax administrators, academics, practitioners, and documentary evidence. Convergent evidence strengthened the interpretation of findings, while divergent perspectives were retained as substantive policy trade-offs. Quotations originally provided in Indonesian were translated into English while preserving their intended meaning.

The research was conducted from June 2022 to April 2023, with interviews completed in May and June 2023. The legal analysis was therefore limited to the regulatory framework in effect before the issuance of the ministerial implementing regulation. The study did not estimate the revenue effects of a specific interest-to-EBITDA ratio or statistically determine an optimal threshold. References to a 30% EBITDA ceiling were treated as policy illustrations based on the OECD-recommended corridor and interview discussions rather than as evidence that a 30% threshold would necessarily be optimal for Indonesia.

Table 1. Informant composition and evidentiary function

Code	Informant group	Individuals / sessions	Evidentiary function
P1	House of Representatives, Commission XI	1 / 1	Legislative deliberation and stakeholder perspective
P2	Fiscal Policy Agency	1 / 1	Policy rationale, calibration, and administrative design
TA1-TA2	Directorate General of Taxes	2 / 1 joint	International-tax administration and enforceability
A1-A4	Tax, accounting, and legal academics	4 / 4	Conceptual, sectoral, accounting, and legal scrutiny
PR1-PR2	Tax practitioners	2 / 2	Compliance, predictability, investment, and dispute exposure
Total		10 / 9	Purposive multi-perspective qualitative sample

Note: Codes identify institutional standpoints; they are not used as quantitative weights. Source: Authors, derived from the thesis interview schedule.

Source: Authors, derived from the thesis interview schedule (2023)

RESULT AND DISCUSSION

Sufficiency: protecting the base without overreaching

The case for interest limitation begins with debt bias. Because interest reduces taxable income while dividends do not, debt can produce a tax advantage even when debt and equity serve comparable financing functions. Interviewees from academia and government agreed that this asymmetry helps explain the attraction of thin capitalization. The legitimate policy objective is therefore not to prohibit debt, but to constrain excessive deductions that do not reflect ordinary business conditions.

Under sufficiency, the interest-to-EBITDA approach has an important advantage: it focuses on the level of financing expense relative to the earnings generated by the taxpayer. A company with high interest deductions must have sufficient earnings to deduct them fully. This feature can restrict arrangements that comply formally with a balance-sheet ratio but still place disproportionate interest expense in Indonesia. The approach may also reduce opportunities to manipulate the denominator through debt-to-equity swaps or asset revaluations that increase recorded equity without changing the relationship between interest expense and operating earnings.

However, the same feature can overreach. Low EBITDA does not necessarily indicate avoidance. Inflation, a downturn, changing market conditions, a start-up phase, or the lag between financing an investment and earning revenue can depress EBITDA. Trading businesses may operate with low margins and require working-capital debt. A uniform percentage can therefore deny interest deductions even when debt is commercially necessary and the taxpayer has no avoidance intention. Interview evidence emphasized that low-leverage businesses with low margins could fail an EBITDA test despite carrying modest interest-bearing debt.

DER performs differently. The Indonesian 4:1 ratio is relatively generous and predictable. For many ordinary taxpayers it permits full deduction of genuine interest and is less sensitive to temporary earnings volatility. In that respect, it may better preserve taxpayers' freedom to incur business costs. Yet the permissive threshold can undermine the revenue-protection objective, and the ratio can be managed through changes in equity or the timing of debt balances. Thus, DER can satisfy the non-overreach side of sufficiency but fall short in closing avoidance opportunities.

Relief mechanisms are essential if an earnings-stripping rule is adopted. OECD data cited in the underlying study indicated that a 30% ratio allowed most sampled multinational group entities to deduct all net interest, but Indonesian calibration requires domestic evidence. Average EBITDA could smooth sharp annual changes, while carry-forward relief could recognize timing differences where current financing produces future earnings. A de minimis threshold or sector-specific exception could also prevent disproportionate burdens. The sufficiency assessment therefore supports calibrated design, not automatic transplantation of an international percentage.

Comparative sufficiency assessment

The interview material shows why sufficiency contains two distinct questions. The first is whether a rule is strong enough to prevent erosion of the Indonesian tax base. On this dimension, interviewees from the Fiscal Policy Agency and Directorate General of Taxes considered the 4:1 DER increasingly inadequate. The threshold could be met by most companies and could leave additional borrowing capacity in Indonesia when a multinational group had reached tighter leverage limits elsewhere. The second question is whether the restriction reaches no further than necessary. Here, academics and practitioners emphasized that EBITDA can fall because of circumstances unrelated to tax planning. A rule may therefore be strong against avoidance and still be insufficiently tailored to genuine commercial conditions.

The policy-design account was explicit that the original 4:1 DER was deliberately generous: “At the beginning we set a very generous ratio of 4:1 ... if the purpose had been to prevent tax avoidance, the ratio might have been 2:1” (P2, Fiscal Policy Agency, 30 May 2023; translated by the authors). This statement supports the interpretation that the threshold initially balanced corporate financial health and business adjustment rather than maximising immediate base protection.

The balance-sheet and income-statement approaches also allocate evidentiary risk differently. DER asks whether the amount and composition of capital are within a prescribed relationship. It may permit large interest deductions where the capital denominator has increased, even if operating earnings have not. The interest-to-EBITDA rule asks whether the financing cost is proportionate to earnings, but it can treat a temporary lack of earnings as if it indicated excessive financing. Neither proxy directly proves taxpayer intention. They are administrable presumptions intended to avoid a transaction-by-transaction inquiry. For that reason, safe harbors, carry-forward rules, and targeted anti-abuse provisions are not peripheral concessions; they are mechanisms that determine whether the proxy remains proportionate.

The thesis also records that the fairness of the proxy can vary by industry. Consumer-goods businesses may have low interest-bearing debt but also low EBITDA margins. Trading companies may depend on short-term borrowing to purchase inventory for resale. New ventures may have no positive EBITDA despite substantial genuine investment. In contrast, a mature business with stable earnings and unusually high related-party interest presents a different risk profile. A single ratio applied without differentiation may be easy to state but can produce materially different burdens across those cases.

Productivity: financing neutrality, predictability, and investment

Productivity requires a rule to protect revenue without unnecessarily constraining productive activity. The interest-to-EBITDA approach is comparatively neutral as to the legal source of finance because it does not directly require a particular debt-to-equity structure. Firms remain free to use debt or equity, subject to a limit on the amount of net interest deducted relative to earnings. This flexibility may improve financing decisions by reducing the rule's direct pressure toward equity.

DER, by design, encourages firms to reduce debt or increase equity. This can support healthier capitalization and may formally increase inbound equity investment, including through debt-to-equity conversions. Nevertheless, requiring greater reliance on shareholder capital can impede firms whose shareholders have limited funds or whose business model ordinarily depends on borrowing. Corporate formalities associated with capital increases may also add administrative burdens. DER therefore can promote capitalization but is less neutral toward financing choice.

The productivity advantage of DER is simplicity and familiarity. Taxpayers already understand the 4:1 rule, and the relevant debt and equity amounts are more stable than annual earnings. This makes deductible interest easier to forecast. An EBITDA rule introduces uncertainty because earnings and interest rates fluctuate, and because the calculation may require detailed adjustments. The interview evidence was divided on comparative dispute risk. A government informant viewed the EBITDA comparison as more straightforward than averaging debt and equity, whereas a practitioner considered EBITDA more complex because the profit calculation contains numerous accounting components. Both views are credible and reveal that dispute risk depends heavily on the precision of the implementing regulation.

The evidence reviewed in the thesis did not establish that either approach necessarily discourages foreign direct investment. Earlier studies found no clear adverse investment effect from DER or, in the short term, from an EBITDA-based interest barrier (Buettner et al., 2006; Buslei & Simmler, 2012). Interviewees also noted that investors consider market size, customers, inputs, labor, and broader legal conditions, not only interest limitation. Even so, unpredictability can affect investment appraisal. Clear rules and transitional arrangements remain necessary to avoid creating a negative perception of tax risk.

Overall, the productivity comparison is balanced. Interest-to-EBITDA provides greater freedom of financing choice but lower predictability. DER is familiar and easier to forecast but directs firms toward equity and may constrain debt-dependent business activity.

Administrative productivity and behavioral effects

Administrative simplicity is not identical to the number of mathematical steps. The thesis maps eight broad steps for DER, including identifying debt and equity, calculating monthly averages, establishing the year-end ratio, and determining deductible interest. It maps four broad steps for earnings stripping: calculating tax EBITDA, applying the ratio, determining deductible interest, and calculating any carry-forward or carry-back. This suggests a shorter formal sequence for EBITDA. Nevertheless, each EBITDA step can contain contested accounting and tax adjustments. DER may have more visible steps but use concepts with which taxpayers and auditors are already familiar. The comparative administrative burden therefore depends on the clarity of the underlying definitions, not merely the length of the formula.

The divergence between institutional perspectives is itself an empirical finding. The tax-administration informants regarded the formal earnings-stripping sequence as comparatively direct, whereas a practitioner warned that disputes could increase because EBITDA contains multiple profit-calculation components and accounting treatments (PR2, tax practitioner, 15 May 2023). An accounting academic similarly stressed that a rule referring only to "EBITDA" would permit competing interpretations unless the formula and the treatment of unrealised gains or losses were specified (A3, accounting academic, 30 May 2023).

The approaches also create different behavioral incentives. DER encourages capital injection, debt repayment, or conversion of debt into equity. Those responses can strengthen the statement of financial position, but they may also be formal responses to obtain deductions rather than changes in productive activity. Earnings stripping encourages firms to align interest expense with their capacity to generate earnings. That may reduce excessive debt, but it could also encourage efforts to accelerate EBITDA, defer expenses, or restructure items within the profit calculation. Every mechanical rule changes the variables taxpayers have incentives to manage. Policy evaluation must therefore consider the new planning margins created by the chosen method.

Predictability has a direct productivity dimension. A company deciding whether to undertake a multi-year project needs to forecast after-tax financing costs. DER offers relative stability if debt and capital remain stable. Under an EBITDA ratio, deductible interest may change because of market demand, input prices, exchange-rate movements, or monetary conditions even where the financing agreement is unchanged. Carry-forward relief reduces permanent denial but does not eliminate the cash-flow effect of paying tax before the deduction can be used. Transitional rules and accessible examples would therefore be required to allow businesses to adapt their financing models.

Table 2. Comparative policy assessment: DER and interest-to-EBITDA

Dimension	DER	Interest-to-EBITDA	Interpretive result
Tax-base protection	Indirect proxy; 4:1 viewed as permissive and manageable through balance-sheet variables.	Directly limits interest relative to earnings; closes opportunities left by DER.	EBITDA is stronger against base erosion.

Dimension	DER	Interest-to-EBITDA	Interpretive result
Commercial proportionality	Stable and generally accommodates genuine interest, but can force equity financing.	Can deny genuine interest when earnings are temporarily low.	Neither method is uniformly sufficient.
Financing neutrality	Directly influences the debt-equity mix.	Does not prescribe the legal source of financing.	EBITDA is more neutral.
Predictability and compliance	Familiar, comparatively stable, and easier to forecast.	Sensitive to earnings, rates, and fiscal adjustments.	DER is administratively more predictable.
Planning margin	Debt/equity swaps, revaluation, and timing of balances.	Management of EBITDA components and instrument definitions.	Both require targeted safeguards.
Sector effects	Can constrain debt-dependent sectors.	Can burden low-margin, start-up, or cyclical firms.	Calibration and relief determine fairness.

Source: Authors' synthesis of interview and documentary evidence. The table reports qualitative assessment, not numerical scoring.

Drivers of Indonesia's policy shift

Three factors explain the introduction of the interest-to-EBITDA method. First, OECD BEPS Action 4 recommended an earnings-stripping fixed-ratio rule as a common approach to limiting base erosion involving interest deductions. Indonesia's participation in the BEPS Inclusive Framework encouraged consideration of that recommendation, although implementation was not described by informants as a mechanical legal obligation. Policymakers also regarded EBITDA as relevant because lenders frequently use earnings-based measures to assess performance and debt-servicing capacity.

Second, a global policy trend was moving toward earnings-based interest limitation. OECD corporate tax statistics cited in the study showed that DER remained widely used, but adoption of earnings-stripping rules was growing. Germany's 30% EBITDA rule, including exemptions and carry-forward relief, was treated as a useful comparator, while Malaysia, Japan, Australia, and several European jurisdictions illustrated different designs. The interviews stressed benchmarking across multiple jurisdictions and adapting the result to Indonesian economic and taxpayer characteristics rather than copying a single country.

Third, policymakers and administrators considered Indonesia's 4:1 DER insufficiently effective. The threshold was initially designed generously because Indonesia was reintroducing a thin capitalization rule and sought to avoid disrupting business. Over time, most companies could meet it, while multinational groups could potentially allocate debt to Indonesia after exhausting stricter leverage capacity elsewhere. Balance-sheet strategies could also preserve formal compliance. In the study's illustration, a taxpayer with debt of IDR70 billion and equity of IDR14 billion initially had a 5:1 ratio. A land revaluation that recorded an IDR20 billion revaluation surplus increased equity and reduced the ratio to approximately 2:1, allowing full deduction of

IDR10 billion interest without changing the debt or operating earnings. The illustration demonstrates the conceptual vulnerability of a balance-sheet proxy; it is not presented as evidence that all revaluations constitute avoidance.

The interview evidence also prevents overstatement of international influence. Government and administrative informants treated Action 4 as a policy reference and benchmarking framework, not as a self-executing legal command. The domestic legal change therefore reflects policy learning combined with dissatisfaction with the existing proxy, rather than simple OECD transplantation.

The policy shift should therefore be understood as an attempt to add a more direct anti-base-erosion tool, not as proof that DER has no useful function. The amended statute retained multiple possible methods, leaving open whether Indonesia should substitute, combine, or differentiate them.

Implementation risks

Four implementation risks emerged consistently from the evidence**.** First, compliance and collection costs may rise. Taxpayers that built systems around DER would need to compute and document adjusted EBITDA and may bear additional tax where interest exceeds the threshold. In the study's illustration, IDR50 billion of interest was fully deductible under a compliant 4:1 DER. With fiscal EBITDA of IDR100 billion and a 30% ceiling, only IDR30 billion would be deductible and IDR20 billion would be disallowed. The example demonstrates the direction of the burden but does not estimate an economy-wide effect. The tax authority would likewise incur costs for information systems, guidance, audit procedures, and staff capacity building.

Second, interest-rate and earnings volatility reduce predictability. DER is generally stable unless debt or capital changes materially. Under an earnings-stripping rule, a rate increase can raise interest expense while a downturn simultaneously reduces EBITDA. A taxpayer may comply in one year and fail in the next without changing its underlying financing strategy. Average EBITDA and carry-forward treatment can mitigate this timing problem.

Third, substance-over-form analysis may generate disputes. The elucidation to Article 18 refers to transactions that do not correspond to their actual condition and emphasizes economic substance over formal characterization. This permits scrutiny of purported debt that functions economically as equity, for example where repayment is indefinite or commercially implausible. Yet informants warned that an undefined doctrine can become highly subjective. Taxpayers may view an arrangement as lawful planning while the authority views it as avoidance. Clear indicators, procedural safeguards, and consistent evidentiary standards are therefore necessary to prevent arbitrary recharacterization.

Fourth, commercial and fiscal EBITDA may differ. Financial reporting may use measurements and recognition rules that do not correspond to tax rules. The study distinguishes historical cost and fair-value concepts and notes that unrealized gains, impairment, final-tax income, non-deductible expenses, and other fiscal adjustments can change the base. Comparing fiscal interest expense with unadjusted commercial EBITDA would be internally inconsistent. The government informant therefore favored an adjusted fiscal EBITDA, while an accounting academic suggested beginning with accounting EBITDA and expressly removing irregular or unrealized items. The shared implication is that the implementing regulation must define each component and reconciliation step.

These risks are interconnected. An unclear EBITDA base increases compliance costs and disputes; volatility increases the need for relief; and broad substance-over-form discretion increases collection costs. Effective implementation thus depends as much on administrative design and legal certainty as on selecting a percentage.

Table 3 makes the evidence chain explicit by linking the triangulated source pattern to each finding and its policy implication. The matrix is not a frequency count; it displays how distinct institutional standpoints converged or diverged around the four implementation risks.

Table 3. Triangulated evidence-to-policy matrix

Empirical pattern	Evidence convergence/divergence	Finding	Policy implication
Higher compliance and collection costs	Administrators noted implementation capacity; practitioners stressed taxpayer adjustment and dispute costs.	The burden falls on both taxpayers and the authority.	Phase-in, examples, systems preparation, and de minimis relief.
Interest and earnings volatility	Academic and practitioner accounts converged on annual unpredictability.	A genuine financing arrangement can fail because EBITDA falls or rates rise.	Average EBITDA and carry-forward treatment.
Substance-over-form disputes	Legal and practitioner evidence stressed subjectivity; administrators stressed anti-abuse necessity.	Discretion is necessary but can become legally uncertain.	Objective indicators, evidence thresholds, and procedural safeguards.
Commercial-fiscal EBITDA gap	Accounting, policy, and administrative perspectives converged on the need for adjustment.	An undefined denominator creates inconsistent outcomes.	A closed reconciliation from accounting profit to fiscal EBITDA.

Source: Authors' triangulation of the nine interview sessions and documentary evidence.

The findings support five design implications. First, Indonesia should calibrate the ratio using domestic data across industries rather than presume that the top of the OECD corridor is optimal. Second, the rule should define net interest, fiscal EBITDA, excluded income and expense, negative EBITDA, and the treatment of final-tax and non-taxable items. Third, average-EBITDA and carry-forward relief should be considered to address volatility and investment timing. Fourth, guidance on substance over form should specify objective indicators and procedural safeguards. Fifth, a hybrid approach may be appropriate where industrial characteristics differ materially.

Hybrid design does not necessarily mean applying both rules and selecting whichever produces more tax. It could mean assigning methods by sector or circumstance, using DER as a safeguard where EBITDA is negative, or combining a primary EBITDA rule with targeted leverage provisions. The purpose should be fairness and risk alignment. Industries with low leverage and low margins may be treated differently from highly leveraged or capital-intensive industries. Any differentiation must be administrable and supported by clear criteria to avoid creating new uncertainty.

Figure 1. Evidence-based design logic for Indonesia

Source: Authors' synthesis. The sequence represents design dependencies, not a claim that one uniform ratio is optimal.

CONCLUSION

The interest-to-EBITDA ratio and the debt-to-equity ratio (DER) each satisfy different elements of sound anti-thin capitalization policy. In terms of sufficiency, the earnings-based rule more directly targets excessive interest deductions relative to economic activity and can reduce opportunities arising from balance-sheet manipulation; however, it may also deny deductions to commercially genuine businesses experiencing temporarily low earnings. The DER approach is more predictable and accommodates ordinary business financing, but Indonesia's 4:1 threshold was viewed as overly permissive and potentially vulnerable to tax planning. In terms of productivity, the earnings-based rule provides greater neutrality in financing choices, whereas the DER approach is more familiar, easier to forecast, and may provide stronger incentives for equity financing.

Indonesia's introduction of the interest-to-EBITDA approach was driven by OECD BEPS Action 4, the growing international adoption of earnings-stripping rules, and perceived weaknesses in the existing DER regime. Nevertheless, implementation presents four material risks: higher compliance and administrative costs, volatility in interest expenses and earnings, disputes arising from the application of the substance-over-form principle, and inconsistencies between commercial and tax definitions of EBITDA.

Accordingly, the evidence does not support an unconditional replacement of the DER approach with a uniform EBITDA-based percentage. A more appropriate direction is a carefully calibrated earnings-stripping framework adapted to Indonesian conditions, supported by relief mechanisms such as average-EBITDA provisions or carryforward rules, explicit tax adjustments, clear anti-avoidance guidance, and consideration of a sector-sensitive hybrid design. These measures would preserve the study's central policy balance between protecting the tax base and avoiding unnecessary interference with bona fide business financing. Furthermore, the Indonesian tax authority should conduct comprehensive industry-specific impact assessments before finalizing the applicable ratio, provide transitional guidance and capacity-building programs for taxpayers and tax auditors, and establish a periodic review mechanism to evaluate the rule's effectiveness and adjust the ratio in response to changing economic conditions. Future research should empirically assess the revenue, financing, and investment effects of the selected ratio using firm-level data after the regulation has been implemented.

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