



## LEGAL CERTAINTY FOR MISUSE OF THE INDONESIAN BUSINESS CLASSIFICATION IN FOREIGN-OWNED VILLAS

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### Info Artikel:

Submit: 2025-09-17

Vol: 4

### Keywords:

Indonesian Standard Industrial Classification, Villa Business, Foreign Investment, Legal Certainty, Micro and Small Enterprises

Revised: 2025-10-21

Number: 2

Accepted: 2025-11-18

Page: 150 - 154

### Abstract:

This article analyses legal certainty issues arising from foreign investors' misuse of the Indonesian Standard Industrial Classification in villa business activities and its impact on the protection of micro, small, and medium enterprises. The study uses normative legal research, drawing on statutory, conceptual, and case approaches, supported by doctrinal interpretation and policy evaluation of licensing and supervision mechanisms. The analysis identifies recurring patterns of classification misuse, including registering villa operations under real estate or other accommodation categories, separating operational functions across related entities to obscure the true nature of the business, using local proxy arrangements, and exploiting unclear operational boundaries in licensing practice and weak interagency coordination. These practices create regulatory inconsistency, undermine enforceability, and foster unfair competition that disadvantages local enterprises in tourism-based markets. The findings indicate that stronger legal certainty requires clearer operational criteria for classification selection, integrated verification across licensing and sectoral authorities, risk-based monitoring, and proportional administrative sanctions with due process safeguards. The article concludes that targeted regulatory reform and coordinated oversight are necessary to restore legal clarity and provide effective protection for local enterprises in the villa sector.

## INTRODUCTION

Tourism-driven property development has expanded rapidly in Bali, increasing the number of villas operating as short-term accommodation businesses. This growth creates governance challenges because licensing, supervision, and enforcement must keep pace with increasingly complex business structures and digital marketing channels (Wardana, 2019). Within this context, the Indonesian Standard Industrial Classification serves as a decisive regulatory gateway that shapes eligibility for foreign investment, operational obligations, and the scope of monitoring. As a result, classification integrity is directly connected to public governance quality and the protection of local economic actors. In practice, the villa sector also intersects with taxation and auditing concerns. Business classification affects how authorities identify the true nature of transactions, assess tax obligations, and evaluate compliance risks through audits (Bunyamin *et al.*, 2023). When classification is inaccurate or intentionally manipulated, oversight becomes fragmented, and the traceability of business activities weakens, creating conditions that may enable regulatory arbitrage and reduce the effectiveness of government control. These issues are especially relevant for community service-oriented governance agendas that aim to strengthen accountability, fairness, and local economic resilience (Benge and Neef, 2018; Saraswati and Hadi Santosa, 2021).



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Despite the importance of business classification, many policy discussions and applied studies focus on tourism accommodation growth or on general investment regulation, while paying limited attention to how misclassification operates as a concrete compliance strategy and undermines legal certainty (Warren and Wardana, 2018). Existing analyses often describe licensing problems without mapping the specific modes through which foreign investors can shift villa operations into categories such as real estate or other accommodation to obtain permits that are easier to secure (Nahak and Budiartha, 2021). Consequently, there remains a gap in research that links classification misuse to enforceability, interagency coordination, and measurable risks for local enterprises. This study addresses that gap by examining the legal certainty problem arising from the misuse of the Indonesian Standard Industrial Classification in villa business activities involving foreign investors (CAI and WANG, 2022). The research is designed to connect doctrinal legal analysis with governance implications, including how classification choices influence supervision pathways, tax compliance signals, and audit effectiveness. In doing so, the study positions classification misuse not merely as an administrative error, but as a governance issue with direct consequences for market fairness and the protection of micro, small, and medium enterprises (Suroso, Durahman and Budi, 2024).

Accordingly, this article is guided by two research questions: (1) what patterns of Indonesian Standard Industrial Classification misuse are employed by foreign investors in villa business operations, and (2) what regulatory and supervisory reforms are needed to restore legal certainty and strengthen protection for local enterprises. The novelty of the article lies in its state-of-the-art focus on classification misuse as a structured compliance-avoidance pattern, and in its policy-oriented legal formulation that integrates licensing verification, risk-based monitoring, and proportional sanctions to improve governance outcomes in the villa sector.

## METHODS

This study applies normative legal research using statutory, conceptual, and case approaches, carried out by examining primary legal materials on investment, business licensing, tourism accommodation, and the Indonesian Standard Industrial Classification, supported by secondary materials such as scholarly works, policy papers, and relevant institutional documents (Pawestri *et al.*, 2024). The research setting is Bali, with the case focus on villa business licensing practices involving foreign investors; the "sample" consists of purposively selected licensing and supervision cases documented in official records and supporting materials that illustrate patterns of classification misuse in villa operations. Data collection is conducted through systematic document review and legal material inventory. At the same time, the analytical tools include doctrinal legal interpretation (grammatical, systematic, and teleological interpretation), legal reasoning to assess legal certainty and enforceability, and policy evaluation to formulate recommendations for integrated verification, risk-based monitoring, and proportional administrative sanctions.

## RESULT AND DISCUSSION

The results of the study show a consistent pattern in villa licensing practices in Bali: a discrepancy between the business activities carried out in the field and the classification stated in the licence (Bunyamin *et al.*, 2023; Pawestri *et al.*, 2024). From an examination of licensing documents, supervisory materials, and operational records, it was found that some operators – especially those involved in foreign investment structures – tend to choose "easier" classifications to obtain permits, but continue to operate services that are essentially villas as tourist accommodation. These findings confirm that the main problem is not only administrative, but also concerns legal certainty, as the



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rules being applied are not on target. At the governance level, classification inconsistencies complicate the division of authority between agencies, leading to fragmented oversight. Consequently, compliance cannot be consistently tested because the object being monitored "changes" as it is classified. Specifically, field data indicate that the most common mode is to register villa operations through real estate classification or other accommodation categories. In contrast, daily operations show short-term accommodation services, tourism promotion, guest management, and accommodation service standards (Mandi, Adnyana and Gunapatniyatsunu, 2019).

In some cases, business functions are separated administratively: one entity holds the property licence, another entity manages reservations, and yet another entity handles operational services. This pattern of separation makes licence-based supervision fragmented, even though the service operates as a single business package. From a legal certainty perspective, this situation creates ambiguity: officials are faced with licences that "appear to be in order," but the facts of the operation indicate that accommodation activities are taking place. These findings reinforce the argument that the operational definitions and classification selection criteria are not yet precise enough to prevent deviations.

The data processing results also identified the use of local arrangements as intermediaries to facilitate permit processing and operational control. This scheme expands the scope for concealing business control, so that ownership relationships, primary beneficiaries, and operational controllers are not always clearly apparent in formal documents. In practice, intermediary schemes often run parallel to inappropriate classification, creating a double layer of non-compliance. In terms of governance, this situation increases oversight costs because verification must go beyond simply checking permit documents (Noerdin, 2022; Farhan *et al.*, 2025). These findings are consistent with a trend often discussed in studies of investment policy and tourism regulation: that administrative loopholes and weak coordination between authorities can be exploited to facilitate compliance avoidance. The impact of the above findings is evident in business competition and in the protection of local actors, particularly micro, small, and medium enterprises operating in the tourism ecosystem. When actors with large capital can obtain permits through alternative classifications, an imbalance occurs because local actors must comply with stricter restrictions and requirements in accordance with their actual classification. As a result, competition in terms of price, market access, and bargaining power becomes uneven, while regulatory enforcement becomes unequal. Within the framework of legal certainty theory, this inequality arises because regulations are applied not based on the substance of the activity but rather on labels that can be manipulated. In institutional economic terms, this condition creates market distortions and reduces compliance incentives for law-abiding businesses (Suroso, Durahman and Budi, 2024).

In terms of taxation and auditing, classification discrepancies impact the quality of transaction tracing and compliance risk mapping. Incorrect classification leads to biased business profiling: authorities tend to assess risk based on the type of business listed on the licence, even though transaction patterns and services reflect tourism accommodation activities. Field findings show that when verification relies solely on licence documents, potential mismatches between actual activities and compliance obligations become more difficult to identify. It weakens the effectiveness of audits because compliance testing indicators (e.g., income type, booking patterns, platform cooperation, and guest services) are not read in the appropriate business category. These results demonstrate a direct relationship between classification accuracy, oversight accuracy, and audit effectiveness. From a policy analysis perspective, the study found that the main gap lies in the operational definition boundaries between classifications and verification mechanisms that are not yet integrated. When operational definitions are loose, business actors can engage in administrative



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"forum shopping" by choosing the most advantageous licensing category. In addition, inter-agency coordination (licensing, tourism, investment, and regional supervision) is inadequate to consolidate operational data, ownership, and marketing activities. From a development law perspective, regulations should be designed not only as formal rules, but as instruments of socio-economic engineering that encourage compliance and protect local actors. These findings also explain why enforcement is often ineffective: the objects of supervision are not clearly defined, and the database is not consolidated.

Based on these results, the recommendation that emerges is the need for reforms that reaffirm legal certainty grounded in the substance of business activities. First, the operational definition of classification must be clarified with easily verifiable indicators so that the distinction between real estate and villa accommodation is not obscured. Second, the verification system needs to be integrated across authorities, with a risk-based monitoring approach, especially for businesses identified as running digital accommodation services. Third, administrative sanctions must be proportional and gradual, but strong enough to prevent recurrence, accompanied by due process mechanisms to ensure that enforcement remains fair. In conclusion, restoring legal certainty in the villa sector requires a combination of refining definitions, consolidating data, integrating supervision, and consistent enforcement to ensure effective protection for micro, small, and medium-sized businesses.

## CONCLUSION

This study concludes that legal certainty in the villa business sector in Bali is undermined when foreign investors strategically select the Indonesian Standard Industrial Classification that does not reflect the substance of their operational activities. The scientific findings confirm that classification misuse functions as a regulatory avoidance pattern that weakens enforcement, fragments oversight, and creates unequal competitive conditions that disadvantage local micro, small, and medium enterprises. To meet the research objectives, the study affirms that restoring legal certainty requires a substantive approach to classification selection, supported by clear operational criteria, integrated verification across licensing and sectoral authorities, risk-based monitoring that captures digital operational realities, and proportional administrative sanctions with due process safeguards. Future research should extend this normative analysis by incorporating empirical compliance data and stakeholder perspectives to assess implementation feasibility, enforcement capacity, and measurable impacts on local enterprise resilience in tourism-based markets.

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