



INDONESIA

TAX REFORM IN THE ECONOMIC DOWNTURN

The 2007 Tax Administration Law, which amends the 2000 Tax Administration Law, took effect from 1 January 2008. The law is the result of lengthy discussions in the Indonesian Parliament about tax reform initiated by the Indonesian Government in 2005. Further discussions in early 2008 resulted in the passage of the 2008 Income Tax Law in September 2008. This law amends the 2000 Income Tax Law and came into force on 1 January 2009. The third round of discussions which aimed at amending the 2000 Value Added Tax (VAT) Law is still on going.

A large number of tax regulations were issued between 2008 and early 2009 following the enactment of the 2007 Tax Administration Law and 2008 Income Tax Law. Other tax regulations have also been issued in response to the economic downturn.

The key issues covered in the new tax laws and regulations are summarised below.

Income tax

The 2008 Income Tax Law has reduced the corporate income tax rate for the 2009 year to a flat rate of 28%, down from the previous maximum progressive rate of 30%. It will be further reduced to 25% in 2010. This rate applies to a company's profits determined under Indonesian accounting standards, which resemble the International Accounting Standards.

Certain types of activities are not taxed on a profit basis. Rather, a specified tax rate applies to the gross amount of income without regard to the expenses attributable to it. This tax, generally referred to as final income tax, is typically collected by way of withholding.

In July 2008, the Indonesian Tax Office (ITO) issued a regulation applying final income tax at rates of 2%-6% on construction service fees. All work contracts signed before 2008 are affected by this regime for all fee payments made in 2009 onwards. For all contracts signed in 2008, the regulation applies retrospectively from 1 January 2008. All contracts signed in 2009 are also covered by the regulation.

In November 2008, the government issued a regulation applying final income tax to real estate businesses. Under this regulation, which took effect on 1 January 2009, transfers of land and building rights are subject to final income tax at the rate of 5%. For simple houses and apartments, the tax rate is reduced to 1%.

In February 2009, the government issued another regulation applying final income tax to bond interest income, with effect from 1 January 2009. The tax rate is now 15%, down from 20%. These rules now apply to any Indonesian bonds, i.e. debt securities with a period of 12 months or more. In the past, only exchange-traded bonds were governed by the final income tax regime.

Progressive tax rates, ranging from 5% to 30%, still apply to individual resident taxpayers' income. The 30% top tax rate has reduced from the previous top tax rate of 35%, and applies to an individual's income above Rp500 million (approximately USD41,500).

Withholding tax

A significant portion of the Indonesian Government's income tax revenue is collected through a comprehensive withholding tax (WHT) system. WHT applies to approximately 30 types of services and is accounted for by the recipient of the services at the time an invoice is issued or paid. This WHT is effectively a pre-payment of the service provider's annual income tax liability.

Under the 2000 Income Tax Law, there were five WHT rates (1.5%, 2%, 3%, 4%, and 4.5%). The 2008 Income Tax Law has simplified the WHT structure by setting a single WHT rate for all types of taxable services: 2% of the gross fees. The new WHT rate has been applied since 1 January 2009.

The WHT rate applicable to interest, dividends, and royalties remains the same as before i.e., 15% of the gross income amounts.

Dividend tax

In principle, dividend income received by a resident taxpayer from a limited liability company (generally referred to as a PT company) is taxable as ordinary income. However, if the dividend recipient is a PT company with a minimum shareholding of 25% in the company paying the dividend, the dividend is tax exempt. In this respect, the 2008 Income Tax Law has removed the active business requirement set out in the 2000 Income Tax Law as a condition to obtain the income tax exemption.

In a regulation issued in February 2009, it is stipulated that from 1 January 2009, dividend income received by individual resident taxpayers would be subject to final income tax at 10%. Under the 2000 Income Tax Law, such dividends had to be combined with the individuals' other income and could be taxed at the maximum tax rate of 35%.

2009 CFC rule

In December 2008, the Finance Minister issued a new regulation covering controlled foreign corporations (CFCs). The new regulation is effective from 1 January 2009 and applies to Indonesian tax residents owning at least 50% of the paid-up capital (shares) in a controlled foreign corporation (CFC). Unlike the previous 1994 CFC rule, which was aimed at combating certain types of tax avoidance and tax evasion, the 2009 CFC rule makes no reference to such issues and therefore applies even if the CFC is domiciled in a non-tax haven country. The only situation in which the rules do not apply is where the CFC's shares are listed on a recognised stock exchange.

In summary, the 2009 CFC rule provides the following:

1. Shareholders to which the CFC rule applies are deemed to receive dividends from their CFC in the fourth month after the deadline of the annual corporate income tax return filing in the relevant country. If there is no deadline for annual tax return filing, or no requirement to file annual tax return, the dividends are deemed to be received in the seventh month after the end of tax year.
2. The deemed dividends are determined in proportion to the shareholding percentage and must be based on the CFC's after-tax profits.
3. The rule does not apply if the CFC has distributed dividends to the qualifying shareholders consistent with the CFC formula before the designated months.

4. Any dividends received by qualifying shareholders in excess of the deemed dividends, or which do not constitute part of the deemed dividends, must be reported in the shareholders' annual tax return for the year in which the dividends are distributed.
5. Dividend tax paid or withheld abroad may be claimed as a tax credit by shareholders for the year in which the tax is paid or withheld.

Anti-avoidance provision

The 2008 Income Tax Law explicitly prohibits the use of a special purpose company established in a tax haven country as a vehicle for holding shares in a PT company or an Indonesian permanent establishment (PE). Sale of the shares in the interposed "special purpose company" will be deemed as sale of the shares in the underlying PT company, or sale of the PE, and subject to Indonesian tax accordingly.

Pursuant to a regulation issued in December 2008, sales or transfers of shares in such special purpose companies are taxed at 5% of the selling price of the shares from 1 January 2009. The Indonesian PT company is responsible for the settlement of the tax liability.

The operation of the above regulation is subject to the terms of any applicable tax treaty.

Exit tax

Exit tax is the tax applicable to resident taxpayers who go abroad. From 1 January 2009, individual resident taxpayers who have obtained a tax identification number are exempt from exit tax. The exemption also applies to a spouse and dependants covered in the official family card.

Exit tax will continue to apply to resident individual taxpayers without a tax identification number until 2010. The tax is due at the time of departure to a foreign country at the following amounts:

Means of trip	Exit tax (Rp)
By air	2,500,000
By sea	1,000,000
By land	-

The exit tax paid by an individual may be claimed as a tax credit when he/she has obtained a tax identification number. This should be done through his/her individual income tax return (Form 1770) filed with the ITO for the same year in which the exit tax has been paid.

Tax incentives

Fiscal stimulus

In late February 2009, the Indonesian Parliament approved a fiscal stimulus package worth Rp73.3 trillion (USD6.7 billion). The package was proposed by the government to alleviate the hardship brought about by the economic downturn. The package includes a general income tax cut of Rp43 trillion, government borne-tax and import duties of Rp13.3 trillion and infrastructure spending of Rp9.7 trillion. The remaining Rp7.3 trillion will provide an energy subsidy and financing for the support of small business activities.

The general income tax cut of Rp43 trillion is mainly attributable to the tax rate reduction under the 2008 Income Tax Law. The government-borne tax includes targeted employee income (payroll) tax concession. The value added tax (VAT) concession (worth Rp3.3 trillion) is intended for the upstream industry sectors involving in oil, gas and geothermal energy, and in the distribution of low-priced palm oil palm. The payroll tax concession (worth Rp6.5 trillion) has been granted to labour-intensive industries which have been severely hit by the economic slowdown.

Reduction of monthly income tax instalments

Amid concerns over tightening liquidity, the ITO announced two concessions in early February 2009 that will help taxpayers seeking a reduction in their monthly income tax instalments (generally referred to as PPh 25) due in 2009.

Under the first concession, a discount of up to 25% of the standard PPh 25 can be obtained for the PPh 25 due for the January-June 2009 period. The discount does not apply automatically. However, taxpayers seeking the discount only need to notify the ITO in writing by 30 April 2009 and provide an estimate of income tax liability likely to be due for 2009 and a statement of the discount desired. Under the normal procedure, a PPh 25 reduction must be based on specific approval of the ITO.

For the second half of the year, as the second concession, the Director General of Taxes (DGT) has announced a simplified procedure for applying for a PPh 25 reduction and the DGT will have to respond within 15 working days from which a request for reduction is made. Under the normal procedure, the time frame for responding is 30 working days. Applications under this scheme must be filed with the ITO no later than 30 June 2009.

The concessions are available for all companies except banks, state-owned companies, go-public companies, and any companies subject to a legal requirement to publish regular financial statements. These companies must determine PPh 25 based on their regular financial statements.

Tax-neutral mergers

Tax-neutral merger regulations were issued by the Finance Minister in March 2008 and the ITO in June 2008. Subject to the ITO's approval, the regulations allow a transfer of assets in a merger to take place at book value for tax purposes. An application for the ITO's approval must be submitted no later than six months after the effective merger date. The ITO will then respond to the application within a maximum of one month from the filing date. If no response is issued by the DGT within a month, the application is deemed to have been approved.

Applicants of tax-neutral merger must satisfy the following conditions:

1. **Determination of the surviving company:** When two or more companies merge, the surviving company should be the one either without outstanding commercial and fiscal losses or with the lesser amount of such losses.
2. **Business purpose test:** The merger should aim at creating a business synergy and a more solid capital structure, and must not have been carried for the purposes of tax evasion.
3. **Merging companies' business status:** The business activities of the merging companies that transfer assets to the surviving company should continue up to the effective merger date and should be carried out subsequently by the surviving company for at least five years.
4. **Prohibition from transferring qualifying assets:** The surviving company should retain the assets received from the merging companies for at least two years following the effective merger date.

Any breach of the above conditions may result in the DGT cancelling the tax-neutral merger approval.

Tax cut for public companies

With effect from 1 January 2008, a 5% corporate tax cut was granted to public companies that satisfy all of the following conditions:

1. At least 40% of their paid-up shares are publicly owned;
2. The public should consist of at least 300 individuals, each holding less than 5% of the paid-in shares;
3. The first two conditions are maintained for at least six months (183 days) in a tax year.

If any of the above conditions are not met in a particular year, the 5% tax rate reduction does not apply for that year.

Indonesia

Free trade zones (FTZs)

A FTZ is an area in Indonesia in which entities are exempted from import duties, VAT, Luxury Sales Tax and excise.

In January 2009, the government issued a regulation regarding the tax, customs, and excise treatment for goods brought into and out of FTZs. The regulation is intended to implement the 2007 Free Trade Zone Law. Batam, Karimun, and Bintan (the three main islands located approximately 32km from Singapore) have been designated as a FTZ.

Tax administration

Transfer pricing documentation

By law, related-party transactions must be carried out on terms consistent with the arm-length principle. If the arm's length rule is not followed, the ITO may make a transfer pricing adjustment in respect of the transaction concerned. The law does not explicitly specify the documentation requirements that must be met by taxpayers to satisfy the ITO that related party transactions have taken place on arm's length terms.

In December 2007, the government issued an implementing regulation to the 2007 Tax Administration Law which came into effect from 1 January 2008. The regulation specifically requires that taxpayers engaged in related-party transactions prepare transfer pricing documentation to prove their adherence to the arm's length principle. However, the regulation still does not provide details of the documentation requirements that must be met. Further implementation regulations are awaited.

Tax audit and dispute resolutions

The 2007 Tax Administration Law sets out three main rules related to tax audits. The first one, referred to as the one-month rule, requires any documents or data required in a tax audit to be delivered to the tax auditors within a month from the request date. Documents delivered beyond a month will be ignored by the tax auditors. If a taxpayer fails to deliver the required documents, the tax auditors may determine the taxpayer's tax liability on a deemed profit basis, or proceed to tax crime probing.

The second rule governs what tax auditors are required to do at the final stage of a tax audit. Failure to carry out these actions may lead to the cancellation of the corresponding tax assessments:

1. Deliver a written notification of the tax audit findings to the taxpayer being audited.

2. Hold a close conference between the tax auditors and the taxpayer, i.e. a final discussion about the tax audit findings before they are put into a tax assessment.

The third rule gives taxpayers an option of settling a tax assessment only as much as they have agreed in the close conference and contesting the unpaid portion in a tax objection. If the taxpayers do not agree with all audit adjustments in the close conference, they may choose not to settle the tax assessment in its entirety. This rule overturns the long standing pay-first-argue-later rule under which filing of an objection letter did not provide a reason for postponing the payment of a tax assessment.

However, if an objection is unsuccessful, the taxpayer will be subject to an administrative penalty amounting to 50% of the unpaid portion of the tax assessment and the total amount is due within a month of the objection decision. If the taxpayers do not agree with the objection decision, they can file an appeal with the tax court without paying the penalty and the unpaid portion of the assessment. However, if the appeal is unsuccessful, the administrative penalty will increase to 100%.

Statute of limitation

Under the 2007 Tax Administration Law, the ITO may now issue an additional tax assessment letter for a particular tax year within five years of the end of that tax year in cases a tax audit is being conducted instead of ten years as before. After five years, the ITO may no longer issue an additional tax assessment letter, except where the taxpayer has been declared by the state court to have committed a tax crime.

The new statute of limitation is applicable for tax years from 2008 onwards. The ten-year statute of limitation still applies to tax years up to 2003. However, for 2004-2007 tax years, as part of the transitional provisions, the ITO is only allowed to issue tax assessments within the period up to 2013.

Sunset Policy

Level of tax compliance has been a serious concern to the Indonesian Government. At the beginning of 2008, only 7.2 million taxpayers (consisting of 5.3 million individuals and 1.7 million companies) have been registered with the ITO. Given that the total population of Indonesia is 237 million, the number of registered taxpayers is considered to be low. In addition, many of the registered taxpayers have reportedly failed to both pay tax correctly and file tax returns regularly.

The Sunset Policy is a government program mandated by the 2007 Tax Administration Law, aimed at increasing the number of registered taxpayers and overall tax compliance level. It provides a limited amnesty and encourages registered taxpayers who have filed incorrect annual income tax returns to revise their tax returns and settle any payment shortfalls. Unregistered taxpayers who do not have a tax identification number (generally referred to as “NPWP”) are also being encouraged to register with the ITO to obtain an NPWP and settle their past tax liabilities during the Sunset Policy period.

The program was effective from 1 January 2008 to 28 February 2009 for taxpayers who had obtained an NPWP before 2008. All years up to 2006 are covered by the Sunset Policy for these taxpayers. For taxpayers who obtained an NPWP in 2008, the program continued for an additional month until 31 March 2009. All years up to 2007 are covered by the Sunset Policy for these newly registered taxpayers.

Income tax payments covered by the Sunset Policy are exempt from interest penalties, which are otherwise payable at 2% per month. Further concessions include the ITO will not conduct an audit of the qualifying tax returns (unless they are found to be incorrect), nor will the ITO use the data in the tax returns covered by the Sunset Policy as a basis to issue assessments of any other taxes. A taxpayer may even be able to stop an on-going tax audit for a particular year by filing a qualifying tax return for that year.

The program has proved to be successful. Between the beginning of 2008 and 28 February 2009, there were more than 5.5 million taxpayers registered with the ITO thereby increasing the number of NPWP holders to 12.7 millions. The Indonesian Finance Minister also stated, in a recent hearing before the Parliament, that more than 804,000 taxpayers filed revised tax returns under the Sunset Policy and paid tax amounting to Rp7.46 trillion (approximately USD678 million) for the period up to 28 February 2008. This amounts to 1.3% of the budgeted 2008 tax revenue of Rp592 trillion (approximately USD49 billion).

Other elements of tax reform

The Parliament is still discussing the proposed bill on the VAT Law amendments. The proposed changes are summarised below:

1. **Zero-rating VAT on export of intangible goods and services:** Under the current VAT legislation, the export concept applies only to tangible goods. The proposed bill aims at expanding the scope of the concept to

intangible goods and services. If approved, the rule will not only relieve the VAT of non-residents of Indonesian on services and intangible goods provided by Indonesian entities but also entitle Indonesian service providers and Indonesian suppliers of intangible goods to refunds of the corresponding input tax.

2. **VAT in a business merger:** Transfers of goods in a business merger would be regarded as a non-taxable event.
3. **VAT in a finance leasing transaction:** It is proposed that the goods in question should be deemed to be transferred directly from the supplier to the lessee. Under the current legislation, the goods are treated as passing through the lessor before they reach the lessee.

Although the proposed bill has been placed before the Parliament for more than three years, there is a general expectation that it will not be passed into law soon, given the tight general election agenda this year. The election of parliamentary members will take place in April 2009 and the presidential election will take place in October 2009.

