

On this issue:

GR 94/2010

- Further regulations are required to implement the tax holiday provision
- The tax treaty benefit claim procedures may be simplified
- By default, shareholders loans should follow the arm's length principle. Only in a certain set of circumstances can noninterest-bearing loans be accepted by the DGT
- The WHT due dates are clarified by way of examples
- WHT tax slip can be claimed as a tax credit in accordance with the WHT date without regard to the income recognition.
- "Defective" tax invoices may be claimed as a deductible expense if the economic substance is satisfied
- Companies whose income is subject to final income tax need to identify the nature of the forex gains/loss: whether or not they are related to business operations. Different natures warrant for different tax treatments

Paving the way for a tax holiday

The Government has paved the way for a tax holiday by the issue of Government Regulation 94/2010 (GR 94) in late last year. To be eligible for the facility, a company must make a new investment in the pioneer industries which bear a broad linkage with other industries, provide high added values, introduce new technology, and are of strategic position from the national economic priority.

It is too early at this stage to judge how attractive the facility is to investors as implementing regulations are yet to be issued. However, any measures aimed at reducing tax burdens should be welcomed by business community; and tax holiday for sure bears this feature.

The income tax law does not explicitly address tax holiday. However, it provides a taxable income reduction of 30% of the qualifying investments which must be spread over six years. The other facilities include accelerated depreciation, a prolonged tax loss carry forward period, and dividend tax rate reduction for foreign taxpayers.

GR 94 states that taxpayers not enjoying those tax facilities, by virtue of Article 18(5) of the 2007 investment law, may be granted income tax exemption or reduction if they make new investments in the designated pioneer industries. This is a typical feature of tax holiday.

Besides pledging tax holiday, GR 94 sets out a number of rules pertaining to the calculation of taxable income and current year income tax settlement. What follows is a summary of these rules.

1. Tax treaty benefit claim

Under Indonesian tax legislation, non-resident parties are subject to income tax in respect of their income earned in Indonesia. Unless they carry out a business in Indonesia through a

permanent establishment (PE), the income tax must be settled by way of withholding at 20% by the Indonesian parties responsible for the payment of the income.

Where a tax treaty is in force, the withholding tax (WHT) may either be exempt or reduced to a lower rate. However, the benefit cannot be taken for granted. The claimants must fill out a long-list document, get it signed or legalized by the competent authority of their country and then present the completed document to the Indonesian tax office (ITO) before the WHT is due.

The use of this document, sometimes referred to as certificate of beneficial owner, and the procedure to produce and complete it has raised an issue of concern not only from taxpayers but also from some treaty partners. GR 94 appears to signal a simpler procedure than the one now in place mentioning only a proper certificate of domicile as a basis to claim tax treaty benefits. The director general of tax (DGT) must issue an implementing regulation on this matter.

2. Non interest-bearing loans

By default, the arm's length principle should prevail in the business and commercial arrangements between a limited-liability (PT) company and its shareholders. It follows that shareholders loans granted to PT Company should bear arms length interest.

However GR 94 allows non-interest bearing loans from shareholders if all the following conditions prevail:

- The loans are financed with the shareholders' own funds and not with other parties';
- The capital that must be paid by the shareholders providing the loans has actually been fully paid;
- The shareholders providing the loans are not in a loss position; and
- The company enjoying the loans suffers a financial difficulty hampering its going concern

If any of the above conditions are not satisfied, the DGT may deem interest on the loans by reference to the arm's length principle. This normally entails the imposition of withholding tax on the deemed interest.

Companies are advised to revisit their loan arrangements in light of the ruling which was originally covered in the DGT internal letter.

3. Tax withholding due dates

The WHT due date has been an issue of concern for a long time particularly pertaining to accrued expenses, dividends payable and some other types of provisions. The income tax law mentions only that the due date should be the earlier the following dates without any further elaboration:

- The date when the tax object (income) under consideration is paid

- The date when funds are made available for the payment of the income
- The payment due date of the income

GR 94 states that “the date when funds are made available for payment” is relevant for dividends.

“The payment due date of the income” is relevant particularly for interest, rentals, royalty, and service fees. In this respect, reference can be made to the due date specified in the relevant contract agreements.

No elaboration is made about the “the income payment date” in GR 94. It should be borne in mind, however, that withholding tax should be settled on the income payment date if it takes place earlier than the other two dates.

4. Timing of tax credit claims

You may have a situation where you received a WHT slip on particular income in one year while the corresponding income is recognized and booked in your account in a different year. This could happen, for instance, on interest loan which should be due on a quarterly or semi-annually basis in accordance with the loan agreement. The interest and WHT due dates should coincide with each other while interest income should be recognized on an accrual basis in accordance with the prevailing accounting standards.

GR 94 confirms that in such a situation, WHT slip can be claimed as a tax credit in accordance with the WHT date even though the corresponding income is recognized in a different year.

5. VAT claimed as a deductible expense

As a general rule, taxpayers may opt to expense creditable input VAT rather than claim it as a tax credit in their VAT returns. In the past the rule did not apply to “defective” tax invoices though the items to which the VAT is attached were claimable as deductible expenses.

The situation has changed now given that GR 94 calls for only the economic substance as a basis to expense input VAT: the VAT has actually been paid and the corresponding expenditures pertain to the activities to obtain, collect, and secure income. The new rule is in line with Article 6(1) of the income tax law and implies that defective tax invoices are claimable as a deductible expense provided that the economic substance is satisfied.

6. Foreign exchange gains/losses

In general, foreign exchange (forex) gains or losses should be accounted for as income or an expense in accordance with the accounting system adopted by the taxpayer and applied consistently with the prevailing Indonesian Accounting Standards.

However, for taxpayers whose income is subject to final income tax or does not constitute a tax object, forex gains or losses related directly to their business operations should not be treated as income or an expense for tax purposes. Forex gains or losses unrelated to their business operations, on the contrary, are to be treated as income or an expense for tax to the extent the corresponding costs are spent in the course of obtaining, collecting, and securing income.

7. Possible deviation from the matching principle

By default, the accounting of income and expenses must be applied consistently with the matching principle. However, in light of a particular government policy the DGT may apply different rules for certain situations. For instance interest income on non performing loans related to bank restructuring may not necessarily be recognized on an accrual basis. Deviation from the matching principle may also be allowed in light of changes in the Statements on Accounting Standards.

Further development needs to be monitored especially the areas to be elaborated by the MoF and/or DGT regulations yet to be issued.

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