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**Foresight is nothing  
without insight**

# Insight

## Tax regulation update

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This August 2008 edition of Tax Insight includes two recent hot topics in the business and tax practices, i.e. draft of the new amendment of Income Tax Law and regulations on Sunset Policy.

Our Tax Insight provides a glimpse of concepts of the new amendment of Income Tax Law that have been approved by tax law committee of the Indonesian parliament. It is expected that the new amendment of Income Tax Law will become effective 1 January 2009. Our Tax Insight also provides some features of the Sunset policy as regulated under a set of regulations recently issued by the government

We welcome your feedback on Insight and ideas for the next issue.

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# Draft amendment of Income Tax Law

This section provides some key changes introduced in the new amendment of Income Tax Law:

## ► Taxable Income

Additional items have been included as **taxable income** prescribed in the law, such as income resulting from reorganization in whatever form and name; gains from sales or transfers of certain or the whole portion of a mining concession; funding participation or capital contribution of a mining company; additional receipt of tax refund; income earned by *syariah* based business, interest compensation as defined in the Laws on General and Procedure on Taxation; and surplus of the Indonesian central bank.

Draw prizes, income from derivative products transacted in capital market have been added as income that is subject to tax that is final in nature ("Final Tax"). In addition to items specifically described in the law, the new law includes item of 'certain other income', which appears serve the purpose of accommodating additional items subject to the Final Tax. The same as the current law, income that is subject to the Final Tax and the taxing mechanism will be regulated further under government regulations.

**Dividends** received by Indonesian corporate taxpayers from equity participation in Indonesian incorporated entities may qualify as income that is exempt from tax (tax exempt income), to the extent that dividends are paid from retained earning and shares ownership of the recipient in the company paying dividends equals or exceeds 25% of the paid in capital. There is no longer a requirement for the recipient to have an "active business" for it to be entitled for the tax exemption. Such dividend exempt from tax will not be subject to withholding tax regulated under Article 23 of the Income Tax Law. A different rule applies for dividends received by Indonesian individuals, to whom a Final Tax will apply with a maximum rate of 10%.

## ► Tax Exempt Income

In addition to Zakat (Islamic based donation) received by *Badan Amil Zakat* (Islamic religious bodies), the new law has extended **tax exempt income** to include mandatory religious donation/grants received by other religious bodies established or authorized by the Government and received by the rightful beneficiaries. On the other hand, costs relating to the donation/grants are tax deductible in the hands of entities incurring the costs.

Certain qualifying scholarships have also been included as **tax exempt income** (subject to further regulation by the Minister of Finance). Surplus of income earned or derived by non-profitable organizations engaging in the area of education and researches & developments will also be considered exempt from tax, to the extent that the surplus is re-invested to infrastructures supporting the educational and research & development activities within no more than 4 (four) years from the year where the surplus is generated. This is subject to further stipulation of a Minister of Finance regulation. Compensation paid by Worker Social Security Program to certain taxpayers, subject to a Minister of Finance regulation, will also be exempted.

## ► Tax Deductibles

Costs that can be claimed tax deductible include costs that are directly or indirectly incurred for business operations. The amended law has not provided further elucidation of the term 'directly' or 'indirectly' used. Included in such business operation costs are promotional and marketing costs (subject to further regulation of the Minister of Finance). Subject to further stipulation of government regulations, items that can be claimed deductible will also cover certain donations, i.e. donations for national disasters, donation in the framework of research and development activities in Indonesia, donations for development of social infrastructure, donation in the form of education

facilities and donations for development of sport.

A new rule is set for claiming deduction from **bad debts**. As an option of filing legal suit for collection of the debt to the State Court or to the government agency for settlement of state receivable, taxpayers having bad debt may choose to (1) publicize the bad debt in general or special publication; or (2) obtain confirmation from the respective debtor to whom the bad debt has been written off.

There are a numbers of additional business/entities allowed to claim tax deductions from **provision of expenses**. Taxpayers allowed to claim tax deduction from provision of bad debts have been extended to include any corporate entity providing loan/credit facility, factoring companies, consumer financing companies. Further, the Indonesian Deposit Insurance Corporation ("*Lembaga Penjamin Simpanan*") is allowed to claim tax deductions from its deposit reserve. Forestry companies are allowed to claim tax deduction from reserve for reforestation and waste treatment companies from reserve for closure and maintenance of the waste treatment.

There is a slight change in the amount of **non-taxable income** deductions for individual tax payers. The allowable deduction for the respective individual is Rp 15,840,000 (from previously Rp 13,200,000), for spouse Rp 1,320,000 (from previously Rp 1,200,000), for each dependant (max 3 dependants) Rp 1,320,000 (from previously Rp 1,200,000). The allowable deduction for spouse is Rp 15,840,000 if the spouse earns income and the income is combined with the individual's income.

## ► Tax Rates

The highest **progressive tax rate** for individual taxpayers is reduced back to 30%, which applies for income in excess of Rp 500million (table of comparison is provided below).

Amount of Income	Old Law	New Law
Below Rp 25million	5%	5%
Rp 25million to Rp50million	10%	
Rp50million to Rp100million	15%	
Rp100million to Rp 200million	25%	15%
Rp200million to Rp250million		
Rp250million to Rp500million	35%	25%
Above Rp500 million		30%

Subject to further stipulation of a government regulation, the highest rate can be further reduced to 25%.

For corporate taxpayers, the tax rate will be a flat rate of 28% (previously, progressive tax rates range from 10% to 30%), which will be further reduced to 25% from 2010. A reduction of 5% from the top rate applies for certain companies listed and traded in a stock exchange in Indonesia. Corporate taxpayers having gross turnover of up to Rp 50 billion (small to medium scale companies) may be entitled to an incentive in the form of reduced tax rate by 50%. The rate reduction applies on taxable income corresponding to a portion of gross turnover up to Rp 4.8 billion.

#### ► Tax Withholding/Collection

Events causing withholding tax under Article 23 and Article 26 to crystallize have been provided in a greater detail in the new law, i.e. the earlier between payment date, or availability of fund for payment, or at payment due date.

A higher withholding tax rate will apply in a case where the respective taxpayer subject to deduction of the withholding tax does not have a Tax Identification Number (NPWP). In such case, an additional 20% applies for Article 21 income tax and 100% applies for Article 22 and Article 23 income tax.

Purchases of certain goods considered "super luxury" have been considered as objects of **Article 22 income tax** in the new law. This will be further regulated by a Minister of Finance regulation, which may include apartments and private airplanes.

For **Article 23 income tax**, a withholding tax rate of 2% of gross amount will apply cross the board for payments of rentals (unless rentals qualifying for the final tax) and compensation in connection with services rendered. This would definitely provide a more simple system for companies in deducting the withholding tax, compared to

current withholding tax system in which the withholding tax rate applies on certain deemed net income achieving certain "effective" withholding tax rates that could vary from case to case. Payments of dividend, interest, royalty, rewards other than those stipulated under Article 21 income tax remains subject to withholding tax of 15% of gross amount paid.

**Exit tax** will no longer apply for taxpayers who are 21 years of age and have been registered for an NPWP. Those who do not qualify for this are required to pay exit tax up to 31 December 2010.

#### ► Transfer Pricing

Elucidation of the amended Income Tax Law includes profit split method and transaction net margin method as 'other' transfer pricing methods that can be used by taxpayers having related party transactions for determination of the arm's length pricing. Methods of comparable uncontrolled price, resale price and cost plus, which have already been in the previous law, remain acceptable.

#### ► Taxpayers having special relationship

Under the amended Income Tax Law, the tax authorities is given the authority to scrutinize **special-relationship transactions** involving Special Purpose Company ("SPC"), which is defined to be a party established to serve certain intended purposes. One of the new rules is that an Indonesian taxpayer purchasing shares or assets through an SPC will be deemed to be the purchaser of shares or assets provided that the purchaser and SPC have special relationship and the pricing is considered not reasonable.

Further, the amended Income Tax Law appears to have extended definition of *transfer of shares of Indonesian entity* to include *acquisition of shares of an SPC* formed in tax haven jurisdictions that has special-relationship with an Indonesian entity or an Indonesian permanent establishment of foreign entity. Such transaction will be deemed to be a sale or transfer of shares of the Indonesian entity or the permanent establishment. Under Article 26 of the Income Tax Law, sales of Indonesian assets (including sales) by foreign entities is subject to tax withholding of 20% of an

estimated net income prescribed by the tax authorities (for shares of unlisted company, the prescribed estimated net income is currently deemed 25% of gross proceeds).

The amended law also introduces a potential adjustment on the amount of income earned by an individual taxpayer working for an Indonesian employer. Such adjustment can be made, if the employer has special relationship with a foreign entity and the respective employment cost is shifted in any other form of cost or expenses paid by the Indonesian employer to the non-resident entity.

#### ► Tax withholding on cross border transactions

Additional items have been included as taxable objects under Article 26 Income Tax which are (1) **swap premium and other hedging transactions** and (2) **gain from hair cut**. Subject to rules provided in a relevant tax treaty between Indonesia and the country of residence of the entity receiving the income, payments by Indonesian taxpayers in relation to items described in Article 26 of the Income Tax Law (including the above two additional items) will be subject to tax withholding of 20%.

The new law provides that determination of **Beneficial Owner** is not only based on the Certificate of Domicile but also the place of actual residence for individual or the place of establishment for corporate body. The elucidation has also defined the beneficial owner for corporate body to include the country of establishment of the owner or the shareholders with more than 50% ownership (both stand alone or altogether) or where the effective management is located.

#### ► Permanent Establishment

Coverage of **Permanent Establishment** of foreign entities have been extended, to include additional items, such as a warehouse; a space for advertising and sales; a mine and a quarry or any place of extraction of natural resources; a mine work area for oil and gas; and computer, electronic or automatic equipments owned, hired or utilized by the electronic commerce provider to carry out a business through internet. As always, if there is a tax treaty available, determination of a permanent establishment should refer to provisions in the tax treaty.

# Sunset Policy

The Indonesian government has finally issued some regulatory rules for the implementation Article 37 A of the Law on General Rules and Procedures for Taxation, which is commonly known as Sunset Policy.

The Sunset Policy covers direct taxes only, i.e. Individual Income Tax and Corporate Income Tax and it does not cover withholding tax or VAT.

With an intention to provide a mean to encourage taxpayers starting to declare their tax in compliance with the tax laws and regulations, the Sunset Policy provides relinquishment of interest penalty caused from tax underpayment resulting from filing of certain qualifying tax returns. The qualifying tax returns include:

- ▶ Individual Income Tax Returns for year 2007 and before that are submitted by individual taxpayers voluntarily registering for a Tax Identification Number (NPWP) in 2008 (this needs to be submitted prior to 31 March 2009);

- ▶ Amended Individual Income Tax Returns for years prior to 2007 that are submitted by individual taxpayers already registered prior to 1 January 2008 (this needs to be submitted prior to 31 December 2008);

- ▶ Amended Corporate Income Tax Returns for years prior to 2007 submitted by corporate taxpayers already registered prior to 1 January 2008 (this needs to be submitted prior to 31 December 2008).

Tax returns/amended tax returns submitted under the Sunset Policy by individual taxpayers voluntarily registered in year 2008 will not be subject to a tax audit, to the extent that there is no data or information indicating the tax returns to be incorrect, or

Tax returns or amended tax returns submitted would need to have a note stating that the tax return/amended tax return is submitted under Article

37 A of the Law on General Rules and Procedures for taxes.

Tax underpayments declared in the qualifying tax returns or tax return amendments would need to be settled before the tax returns or the amendments can be filed.

Filing of the qualifying amended tax returns under the Sunset Policy is possible for tax returns that are already subject to an audit by tax authorities, to the extent that Formal Notification of Tax Audit Result ("*Surat Pemberitahuan Hasil Pemeriksaan*") has not been issued. Depending on tax being tax audited and circumstances of the tax audit, filing an amended tax return may cause to discontinuation of the tax audit.

The Sunset Policy does not apply in the case where the respective tax return being amended is subject to an investigation for initial evidence, or any action relating to tax crime.

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