Tax
Indonesia

TaxFlash

April 2007 No. 3/2007

IN THIS ISSUE:

- 2007 Investment law
  - Government is attempting to improve and simplify some business investment rules.
  - Labour law and tax law amendments are yet to be released.
- Renewed approach to tax audits
  Taxpayers can now request a review of tax audit results by a separate team of reviewers.
- Domestic withholding tax rates are revised again
  Only compensation for designated services are subject to withholding tax.

2007 Investment Law

The House of Representatives finally passed the proposed investment bill into law last month. It has not been signed by the President, but this is expected soon. Aimed at replacing two separate 30-year old laws for foreign and domestic investors, Law No. 1/1967 and Law No. 6/1998, the 2007 Investment Law signals a much better investment climate than its predecessors. This is reflected in the following features:

- More certainty regarding land right holdings. Cultivation rights (HGU) are extended up 95 years from previously 35 years. Building rights (HGB) may be obtained for up to 80 years from previously 30 years. Land-use rights are also extended from previously 25 years to 75 years.
- Simplified business-related licenses. Subject to further detailed regulations, applications for business-related licenses will be served by the Investment Board of Investment (BKPM) under a one-stop service system. BKPM will act as a coordinator among government agencies, departments, and regional administrations. Within the government, BKPM's position will also be elevated from a part of the trade department to a non-departmental bureau responsible directly to the president.
- Domestic and foreign investors are treated on an equal footing. Both groups will generally have the same access to any business areas despite the government requirement to reserve certain areas for small and medium enterprises and cooperatives. The government will issues a "negative list" in due course. This will contain some prohibited areas for investment or only open under certain conditions. However, if a business area is not on the list, investors can enter the area without restriction. At the moment, the "negative list" has not been issued.
- Longer time for temporary stay permits and shorter time to get permanent ones . A temporary stay permit (KITAS) may be granted for up to 2 years, twice as long as the current standard. The new law allows a KITAS to be converted into a permanent stay permit (KITAP) after a two-consecutive year of stay in Indonesia, much shorter than the current standard of five years.
- Tax break and customs cut facilities for qualifying investments. These include tax breaks for investments which are labour-intensive, of the national top priority, part of the infrastructure development, involve transfer of technology, undertake pioneer industries, carried out in rural areas, involve R&D activities and innovation, environment-preservation oriented, etc.
- Removal of divestment requirement to local partner. Unlike its predecessor, the new law is silent about divestment requirement.

PRICEWATERHOUSECOOPERS

However, the 2007 Investment Law also establishes new rules which may bring about some issues:

- Legal beneficiaries vs. actual beneficiaries. The law prohibits shareholders from entering into an agreement or make a statement that the shareholding is in favour of or for the benefit of other party. Such agreement or statement will become null, invalid and never exists.
- Limited-responsibility nature of shareholders is challenged. A shareholder who "stops, leaves, or abandon his business activities unilaterally in accordance with the prevailing law and regulations" is held responsible for settling any "obligations and losses". The law does not specify the parties to whom the obligations and losses belong.
- Investment activity reports. The requirement to file investment activity reports with BKPM is not something new. However, under current regulation there is no specific sanction for ignoring the requirement. The new law asserts this requirement along with the administrative sanctions for ignoring it in the forms of a warning letter, limitation of business activities, and suspension or cancellation of business activities and/or investment facilities.
- Corporate crimes clause may lead to the cancellation of contract agreements with the government. The government may cancel the contract agreement with an investor on which its business activities are based if the investor is declared by court to commit in corporate crimes in the forms of taxation crimes, mark up of recovery costs, etc. so as to reduce its profits and thereby causing losses to the state.

Renewed approach to tax audits

Second review of the tax audit results can now be available

Recently the director general of taxes (DGT) issued regulation No. Per-176/PJ/2006. This regulation allows taxpayers to formally request a representative in the DGT office to review the tax audit findings if the findings are not agreed by the taxpayers. This should help reduce the incidence of overly large or inequitable assessments. This "second review" must happen during the audit period. It is not an objection type process which remains to be available after assessments are issued.

Two-level reviews may be performed. The first one must be carried out by a reviewer team from the tax office unit to which the tax audit team belongs, e.g. a district tax service office (KPP), or a tax audit office (KARIKPA). If the taxpayer is not satisfied with the results of the first review, they may ask for a second-level review to the head of the regional tax service office. In this respect, a closing conference should only be held after the regional office issued their review results.

Domestic withholding tax rates are revised (again)

The DGT issued Per-70/PJ/2007 (Reg.70) on 9 April 2007 regarding Article 23 withholding tax on compensation for services. Aimed at replacing Per-178/PJ/2006, which was issued only in December 2006, Reg. 70 brings about the following changes:

- Reducing the withholding rates for rentals of land transportation vehicles from previously 3% to 1.5% and for rentals of other assets, except land and building rentals which are subject to final income tax, from 6% to 4.5%;
- Certain services are removed from the list, i.e., courier, travel agent, travel bureau, and freight forwarding services. As a consequence, compensation for these services should no longer be subject to Article 23 withholding tax.
- Provision of places and/or time in mass media, outdoor media, or all other media for information dissemination is subject to Article 23 withholding tax at 1.5%.
- Compensation for certain other designated services will have Article 23 withholding tax of 4.5%. Unlike Reg. 178 which included any other (undesignated) services as falling within the withholding net with a withholding rate of 4.5%, Reg. 70 only will only target the designated services.

Reg. 70 provides a detailed list of services whose compensation is subject to Article 23 income. Interestingly, Reg. 70 implies that the tax is due only upon payments of designated compensation. It is noted, however, that by law the tax is due at the earlier of payment or accrual. The inconsistency may give rise to an uncertainty.

Your PricewaterhouseCoopers contacts

Ali Mardi
ali.mardi@id.pwc.com

Anthony J. Anderson
anthony.j.anderson@id.pwc.com

Anton Manik
anton.manik@id.pwc.com

Engeline Siagian
engeline.siagian@id.pwc.com

Lili Tjitadewi
lili.tjitadewi@id.pwc.com

Margie Margaret
margie.margaret@id.pwc.com

Nuryadi Mulyodiwarno
nuryadi.mulyodiwarno@id.pwc.com

Robertus Winarto
robertus.winarto@id.pwc.com

Tim Watson
tim.watson@id.pwc.com

Ali Widodo
ali.widodo@id.pwc.com

Ay Tjhing Phan
ay.tjhing.phan@id.pwc.com

Christian Pellone
christian.pellone@id.pwc.com

Heru Supriyanto
heru.supriyanto@id.pwc.com

Margaret Duong
margaret.duong@id.pwc.com

Melisa Himawan
melisa.himawan@id.pwc.com

Ray Headifen
ray.headifen@id.pwc.com

Tomy Harsono
tomy.harsono@id.pwc.com

PT. Prima Wahana Caraka
PricewaterhouseCoopers
Jl HR Rasuna Said Kav. X-7 No. 6
Jakarta 12940, INDONESIA
Tel: +62 21 5212901
Fax: +62 21 52905555 / 52905050
www.pwc.com/id

The information in this publication is prepared for the sole use of partners, staff and selected clients. Whilst every care has been taken in the preparation of this publication, no warranty is given as to the correctness of the information it contains and no liability is accepted for any statement or opinion, nor for any error or omission. When specific problems occur in practice, it may be necessary to refer to laws and regulations and to obtain appropriate advice.

© 2007 PT Prima Wahana Caraka. "PricewaterhouseCoopers" refers to the Indonesian firm of PT Prima Wahana Caraka or, as the context requires, the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.