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2007 tax administration law (KUP) highlights

The 2007 tax administration law (KUP) will be effective from 1 January 2008. Certain provisions are still reliant on implementing regulations to take effect. What follows is a summary of the main issues or changes covered in the 2007 tax administration law:

- **Individual tax registration.** Individual residents who have annual income exceeding the non-taxable threshold are required to register with the DGT office and obtain a tax ID number (NPWP). The law encourages voluntary registration up to the end of 2008. It states, for instance, that tax audits will not be performed on individual residents who register with the DGT office by 31 December 2008 provided that their tax returns are valid. It will also exempt individuals from administrative sanctions in respect of tax year(s) before registration. In contrast, those who receive a NPWP "by force" will not be entitled to these concessions. The law also explicitly states that underpaid tax assessments may be issued for years before registration.
- **Tax return filing.** There will be no longer a requirement to file an annual employee income tax return (F1721). This is applicable commencing the year end 31 December 2008. Companies need to ascertain that the monthly tax compliance reflects a valid calculation of the tax due based on the actual remuneration payable to employees for each particular month. Administrative penalties for late filing have been increased. For VAT and corporate tax, the penalties become Rp500,000 and Rp1,000,000 respectively.
- **Pre-audit refunds.** Not only golden taxpayers are entitled to pre-audit refunds. Subject to an MoF regulation, the facility may be granted to individual taxpayers not carrying out any business (e.g. for claiming fiscal tax). Individual taxpayers who run a business and corporate taxpayers may also enjoy this facility if their turnover and overpaid tax claimed do not exceed certain amounts.
- **Tax audits.** The conditions imposed on tax auditors are mandatory for all types of tax audit: submission of a written notice of tax audit findings to the taxpayer being audited and holding a closing conference with the taxpayer. Missing either condition can render the

tax audit 'defective' which may lead to the cancellation of the tax assessments issued. Taxpayers are required to deliver any requested documents within a month of the request. Missing the deadline may lead the tax auditors to calculate the tax liability on a deemed basis using any documents made available to them. Further, any documents not delivered during the tax audit may not be taken into account in the objection process. This is a significant development and it is now vitally important that taxpayers thoroughly prepare for an audit. Previously the tax office would accept document submission during the objection process.

- **Tax dispute resolutions.** If a taxpayer disagrees with a tax underpayment assessment letter issued, it can choose to pay only as much as it has agreed during the closing conference. If the taxpayer does not agree to any underpayment in the closing conference, then it can choose not to pay the tax assessment letter at all. This is on the assumption that the taxpayer will bring the case to an objection. If the objection is rejected, the taxpayer has to pay the underpaid amount plus an administrative penalty amounting to 50% thereof. The taxpayer may bypass the payment requirement if it files an appeal with the tax court. However, if the appeal is rejected, all underpaid tax must be paid along with an administrative penalty totalling 100% thereof. It is noted that the tax court law requires a payment of at least 50% of the tax due before filing an appeal. This requirement contradicts the tax administration law. Hence, an uncertainty may prevail until the two laws are harmonized. Until this inconsistency is resolved taxpayers may have no choice but to pay 50% of the tax in dispute to ensure the Tax Court does not reject its appeal.
- **Several responsibility.** The several responsibility rule pertaining to a sale-purchase transaction of particular taxable goods or services is deleted. As a consequence, vendors are solely held responsible for the settlement of VAT due on a particular transaction with the government (state treasury/DGT).
- **Revision of pre-2007 tax returns.** The law indicates that the government may provide an exemption or reduction of interest penalties arising from a revision of pre-2007 tax returns made in 2008. It is not clear whether this will be applicable for any pre-2007 years or only 2006 tax year. An MoF regulation is awaited.

New income Tax Law and VAT Law unlikely to be effective from 1 January 2008.

The two other tax bills are still under discussion within the House of Representatives. However, the House has been in recess since 7 December and will reconvene on 7 January 2008. It is therefore very unlikely that these two bills will take effect in 2008.

Tax-neutral merger, is it still possible?

By default, the income tax law requires that transfers of assets in a business merger must be accounted for at market values. However, the law authorises the minister of finance (MoF) to regulate otherwise. The MoF has issued 422/KMK.04/1998 as amended by MoF 75/PMK.03/2005 (MoF 422) which allows a tax-neutral merger.

The basic idea is that assets are transferred from the dissolved entities to the surviving entity at tax book value. Neither capital gains nor losses arise from such transfers and accordingly income tax will be zero. There is also an opportunity to obtain a discount on any *duty on land and building transfers* (BPHTB) of up to 50%. Moreover,

withholding tax on transfers of land and building rights, which is 5% under normal circumstances, does not apply. Specific approval from the director general of tax (DGT) is required to enjoy these concessions.

Many companies have enjoyed this facility following the DGT's specific approval. Nevertheless, a new and unexpected interpretation of MoF 422 has reportedly developed within the DGT office which has led to approval of tax-neutral mergers being declined.

Referring to the literal wording of MoF 422, the new interpretation points out that a tax-neutral merger can only occur if all combining entities, except the surviving entity, are liquidated. In light of the prevailing company law, the requirement is something unnecessary and in practice impossible. It has also been mentioned that tax-neutral mergers were introduced as a result of the 1997-1998 financial crisis and because the crisis period is over, there is no need for such mergers.

It is debatable whether or not the new interpretation is valid. However, the most crucial issue is whether the government, in particular the MoF, is still interested in allowing tax-neutral mergers, for instance to improve the overall investment climate. Clarification or possibly a new regulation from the MoF is awaited. We understand a new MoF ruling is imminent. Taxpayers contemplating a tax-neutral merger need to carefully monitor developments in this area.

Tax facilities for new investments

More than 50 companies have reportedly received approval for new tax facilities pertaining to their investments made in 2007. In accordance with GR 1/2007, investments in particular business areas or designated regions are eligible for several tax facilities:

- An investment allowance amounting to 30% of the qualifying investments, to be allocated over six years (5%/year)
- Accelerated depreciation-twice as fast as the normal depreciation rates
- Extension of tax loss carried forward period for up to ten years from the normal period of five years
- Reduction of Article 26 income tax on dividends paid to non-resident shareholders to 10% from the normal rate of 20%.

GR 1/2007 provides a detailed list of eligible business areas and regions. Please note that the facility will only be granted by the DGT (on behalf of the MoF) following a recommendation from the Investment Coordination Board (BKPM).

Tax planning points for year end

As year end is almost here, some measures can potentially be taken to reduce your 2007 income tax:

- **Bad debt write off.** To be eligible as a deductible expense, a bad debt write off must satisfy four conditions: commercially expensed, supported by a debtor-creditor agreement, published in newspapers/magazines, and

notified to the DGT. There may still be a few days to complete the missing conditions to enable a bad debt deduction.

- **Capital expenditure.** For tax, depreciation of fixed assets should start from the month of acquisition not the month of first use. Any capital expenditure in December in 2007 will result in a one-month depreciation expense for tax.
- **Assets scrapping.** Certain assets may no longer be used in operations and written off to the profit and loss for accounting purposes. For tax, unless they have passed their useful life, depreciation should still continue until the assets have been physically scrapped. Supporting documents for the scrapping process are essential for claiming tax deductions.
- **Inventory write off.** Provisions for obsolete goods (inventories) are non-deductible for tax. A tax deduction may be claimed in the same year when the goods are physically written off or transferred (sold) to other parties. Supporting documents for the scrapping process are essential for claiming a tax deduction.

Final income tax regime is under discussion

The final income tax regime is under discussion within the government. This regime may be re-introduced for certain business areas. It may potentially apply to the construction industry. In the past, final tax was applicable for property development and consulting businesses. Now it is only applicable for certain types of income such as:

- Land and building rentals
- Interest income earned from banks operated on Indonesia
- Sale proceeds of shares traded on Indonesian stock exchanges
- Interest on bonds traded on Indonesian stock exchanges

If the regime is extended, it is important taxpayers understand the transitional provisions and consider how any adverse impacts can be mitigated.

Further developments are awaited.

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