

Tax Bulletin

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Implications of New Indonesian Capital Gains Tax on Singaporean Investors

Overview

With effect from 24 August 1999, a new Decree provides that gross income from the sale, by non-residents, of non-listed shares in Indonesian companies is subject to a 5 per cent final withholding tax in Indonesia. This development affects all Singapore companies investing in Indonesia because Singapore's tax treaty with Indonesia does not protect Singapore residents from this tax. We suggest that all companies with investments in Indonesian companies should carefully review existing structures to determine their exposure to the new tax. Planning alternatives may be available to correct existing structures, which are susceptible to the imposition of the tax. New structures should clearly now include planning for a 'sell down' without the application of Indonesian, as well as foreign, taxes.

Background

Indonesia has, since 1 January 1995, included a provision in its domestic tax law that seeks to impose a final withholding tax on gains arising from the disposal by non-residents of Indonesian property. Regulations were issued to impose a final withholding tax on the disposal of shares (by residents and non-residents) in publicly listed Indonesian corporations. However, until the issue of this new Decree, no implementing regulations were promulgated to impose tax on the disposal of shares in non-listed Indonesian companies by non-residents.

New Decree

Pursuant to this new Decree, gross income on the sale of shares in limited liability companies incorporated in Indonesia (Company) by a non-resident (without a permanent establishment in Indonesia) is subject to 5 per cent

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final withholding tax. Residents (including permanent establishments) will continue to be taxed on such gains under ordinary principles and there is no change to the final tax applicable to the sale of shares on the stock exchange.

The Decree acknowledges that non-resident taxpayers may be protected from tax by Double Taxation Agreements (DTAs) and the vast majority of Indonesia's 47 DTAs provide such protection. However, the Singapore-Indonesia DTA does not contain a 'capital gains' article and a senior Indonesian Tax Office (ITO) official has indicated that gains from the sale of shares will, in his view, be covered by the 'Income not expressly mentioned' article of the Indonesia-Singapore DTA. This senior ITO official does not accept that such gains could be covered by the 'business profits' article of the Singapore-Indonesia DTA (e.g. refer to the decision in the *Thiel* case in Australia). The result is that Indonesia's taxing rights are generally not affected by the Singapore-Indonesia DTA. One exception to this may be share traders.

The collection procedure is as follows:

- On sales to a non-resident taxpayer - the tax is collected by the Company on behalf of the non-resident shareholder.
- On Income from 'the sale of shares in Indonesia' - the tax is collected by the 'purchaser that has been designated as a collector'. The operation of this provision is unclear because the Decree does not explain when shares are considered to be sold in Indonesia and does not designate any tax collectors.

According to the Decree, the Company is not allowed to register the share transfer until evidence of the tax payment has been produced.

Other key points to note are:

- The tax applies to gross proceeds (regardless of whether the shareholder has derived a profit or loss).
- The Company may not have any rights to recover tax withheld on behalf of the non-resident shareholder. If the tax is not recovered, the cost would most likely be non-deductible for corporate tax purposes.
- Shareholders are required to inform the Company of the sale of shares but it is not necessary for the shareholders to disclose the sales price. The ITO may find it difficult to audit this and the Company may find any adjustment by the ITO difficult to defend.

- The Decree does not make it clear at what point in time the withholding tax obligation arises. This is relevant for the purposes of determining whether or not the tax applies, the tax due date and the appropriate exchange rate for sales transacted in a foreign currency. Possibilities include the date of registration by the Company, signing of share transfer agreement or payment of the consideration.

Implications for Singaporean investors

The lack of protection from the Indonesian taxes applicable to the disposal of shares in a company incorporated in Indonesia is a disadvantage to:

- Singaporean investors; and
- Other foreign investors using Singapore as a location for an intermediate holding company.

In the past, Singapore has been a popular choice as an intermediate holding company jurisdiction for investment into Indonesia. However, in assessing structures for new investments into Indonesia, consideration should be given to the weakness in the Singapore-Indonesia DTA. Currently, Mauritius is a popular choice for an intermediate holding company because that DTA provides a 5 per cent rate of withholding tax for non-portfolio investments (the lowest out of all of Indonesia's DTAs) and protection from Indonesian capital gains tax.

Where an existing Singapore holding company structure is in place and consideration is being given to the divestment of shares in an Indonesian company, it may be possible, with careful planning, to reduce or eliminate the Indonesian capital gains tax.

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