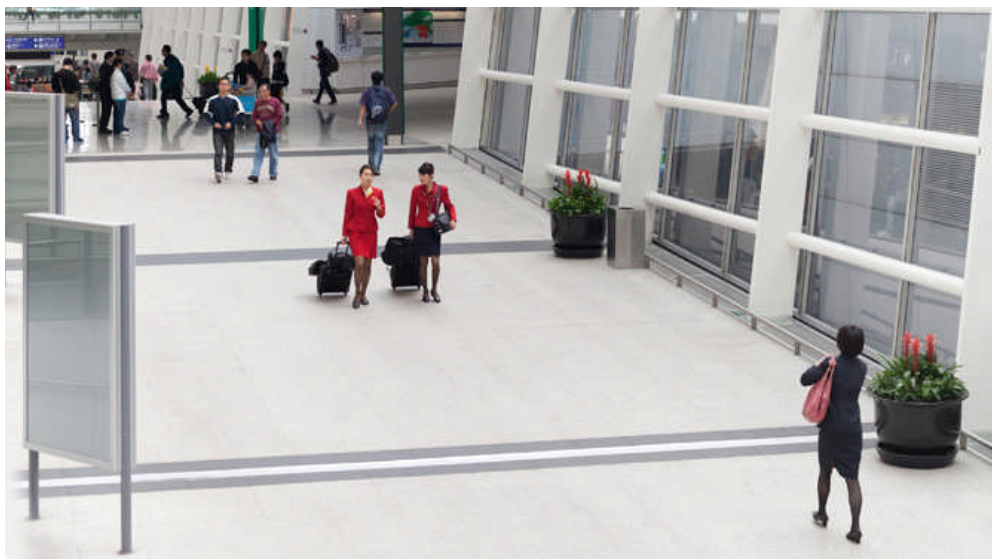




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The Indonesian Tax Office (ITO) has been busy finalising a relatively large number of new regulations in December 2011. These regulations, even though dated the end of December 2011, were only released to the public by early to mid January 2012. In this edition, we bring to you several regulations of which we believe it is important you are aware. We will discuss Government Regulation No.74/2011 as the new implementing regulation of General Tax Provisions Law No.16/2009 in the next edition of TaxFlash.

International Taxation

Cross border tax audits and tax collections

The Director General of Taxes (DGT) has issued guidelines on cross border tax audits and tax collections, which provide more certainty to taxpayers about the process. The summary of each guideline is provided below.

1. *DGT Regulation No.PER-41/PJ/2011 (PER-41) dated and effective from 28 December 2011 regarding Tax Audit Procedures in relation to the Exchange of Information (EoI) based on a Tax Treaty that Involves the Tax Authority from the Treaty Partner Country*

PER-41 stipulates the procedures of tax audits conducted in a treaty partner country as requested by the Directorate General of Taxes in accordance to the EoI article provided in the relevant tax treaty. This type of tax audit can be carried out when a tax resident of the treaty partner country receives income from Indonesia or has a transaction with an Indonesian tax resident which is being audited and there is an indication of tax avoidance, tax evasion or treaty abuse. In this case, the audit is still conducted by officials of the treaty partner

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country and the officials of the ITO will accompany them. In-country audits may also be conducted for a reverse condition.

At the completion of such tax audit, the Director of Tax Regulation II of the Directorate General of Taxes will provide the following documents to the tax authority of the treaty partner country:

- a) notification on the tax audit result for which audit is conducted in the treaty partner country; or
- b) information requested by the treaty partner country through EoI procedure in relation to the in-country tax audit.

Detailed steps of the cross border tax audits and information that should be provided by the Directorate General of Taxes requesting a cross border audit are attached to the regulation.

2. DGT Regulation No.PER-42/PJ/2011 (PER-42) dated and effective from 28 December 2011 regarding Procedures of Tax Collection Assistance based on a Tax Treaty

Similar to PER-41, PER-42 also provides guidance on cross border tax assessment resolution that requires involvement of a tax treaty country. The Directorate General of Taxes may apply for tax collection assistance in the following conditions:

- a) there is tax payable that can still be collected based on the prevailing regulations;
- b) the taxpayer/tax bearer is not in Indonesia;
- c) there are no more assets of the taxpayer/tax bearer in Indonesia that can be used to settle the tax payable;
- d) maximum efforts to collect the tax payable have been done in Indonesia based on the prevailing regulations;
- e) the tax payable is not a disputed item;
- f) the tax bearer does not have any legitimate reason to decline the tax payable collection;
- g) a series of analyses have been conducted on the cost and benefit of the tax payable upon which assistance with tax collection will be requested from a treaty partner country; and
- h) the tax payable has not expired.

In-country tax collections may also be conducted based on request from the tax authority of the treaty partner country if there is a tax claim that should be settled by an Indonesian taxpayer/tax bearer. The Director of Tax Regulation II of the Directorate General of Taxes will then conduct verification on this request, as to whether this has been in accordance with the relevant tax treaty.

Both the Directorate General of Taxes and the competent tax authority of the treaty partner country will update each other during the process of tax collection and submit a notification at the completion of tax collection.

Detailed steps of the cross border tax collections and information that should be provided by the Directorate General of Taxes requesting a tax collection are attached to the regulation.

Determination of tax resident

The DGT has now stipulated the detailed coverage of tax residents and non-tax residents through the issue of Regulation No.PER-43/PJ/2011 (PER-43), applicable for individual and corporate taxpayers.

Individual taxpayers - expatriate

As stipulated in the Income Tax Law, the resident individual tax subject shall be an: 1) individual domiciled in Indonesia, or 2) individual living in Indonesia for more than 183 days within a period of 12 months, or 3) individual who within a tax year lives in Indonesia and has the intention to reside in Indonesia. In this regard, PER-43 has set out a detailed broad definition of ‘domiciled in Indonesia’ and ‘intention to reside in Indonesia’.

An individual domiciled in Indonesia who later moves overseas may still be considered as having a domicile in Indonesia if their presence overseas is migratory, and the said individual resides in Indonesia for more than 183 days within a period of 12 months.

Individual taxpayers – Indonesian citizen

An individual who is an Indonesian citizen working overseas for more than 183 days within a period of 12 months shall be a non-resident tax subject, provided that the said individual resides permanently overseas and is recognized by valid official identification documents as a resident abroad. Failure to provide the required document and the individual shall be considered as a resident taxpayer.

The income received related to their works outside Indonesia and the income originating from outside Indonesia are not subject to income tax in Indonesia, whilst if the individual receives income originating from Indonesia, the said income is subject to income tax in accordance with the prevailing taxation regulations.

Permanent Establishment (PE)

A non-resident tax subject may carry out activities or business through a PE in Indonesia in the event that the said non-resident tax subject has its seat of domicile of management located in Indonesia. Therefore, PER-43 has also set out the detailed definition of effective management located in Indonesia that may constitute a PE.

PER-43 confirms that in the event that an individual or corporate is a resident tax subject both in the treaty partner jurisdiction and in Indonesia, the status of the said individual or corporate tax subject is determined based on the provisions of the relevant tax treaty.

Financial Services

New clarification circular for life insurance technical reserves

In response to many queries surrounding the tax treatment of technical reserves created for unit link products, the DGT issued Circular Letter No.SE-97/PJ/2011 (SE-97) on 28 December 2011. The circular states that a technical reserve which is created based on final-taxed or non-taxable income is not tax deductible. The technical basis used is Government Regulation No.94/2010 (GR-94), which stipulates that expenses incurred in obtaining, collecting and maintaining final-taxed or non-taxable income are not deductible. GR-94 appears to seek to overrule Ministry of Finance decree No.PMK-81/PMK.03/2009, which allows technical reserves for life insurance companies to be deductible provided certain requirements are met. It also appears debatable whether a technical reserve is in fact incurred in obtaining, collecting, or maintaining final/non-taxable income (which is the basic deductibility requirement). The technical reserve is essentially a provision for future claims.

Historically, it is our understanding that the tax office has accepted the deductibility of the technical reserve. However, the circular (which is an internal DGT guidance letter) is said to be a clarification only and it refers to previous regulations. This implies that the tax treatment could be applicable retroactively. This may raise some concerns for insurance companies that have not been tax audited and have treated their technical reserve as fully deductible.

Insurance companies should review their individual situations to determine the potential tax impact of SE-97 and its potential impact on their financial accounts.

More clarification is being sought by the insurance industry.

Revision of the rules on withholding tax mechanism on bonds

The Minister of Finance (MoF) published regulation No.07/PMK.011/2012 (PMK-07), dated 13 January 2012, which serves as a revision of the implementing regulation No.85/PMK.03/2011 (PMK-85) dated 23 May 2011. PMK-07 will come into effect on 1 February 2012.

Key changes

There are two key changes which basically cancel the changes of tax treatments in PMK-85. These are:

1. The First In First Out (FIFO) method – no longer mandatory for all transactions
Under PMK-85, the FIFO method had to be used for all transactions. Now the FIFO method is only required to be used when determining the acquisition cost and date of a bond sale transaction where the acquisition date cannot be determined. This is similar to the tax treatment prior to PMK-85.
2. Netting off losses is allowed
PMK-85 prohibited the netting off of interest income against a loss incurred in a sale transaction (i.e. due to selling price being lower than acquisition price) when calculating the final income tax due. Now it is allowed, returning to the tax treatment prior to PMK-85.

Transitional clause

There is an additional transitional article, which stipulates that final withholding tax on bonds interest since 23 May 2011 (the effective date of PMK-85) until prior to the issuance of PMK-07 applies as follows:

- If the acquisition cost and date of a bond sale transaction where the acquisition date can be determined, either the FIFO method or the actual acquisition cost and date may be used.
- If the acquisition cost and date of a bond sale transaction where the acquisition date cannot be determined, it remains necessary to use FIFO method.
- Netting off of interest income against a loss incurred in a sale transaction can be applied.

Though this transitional clause is intended to provide fairness to taxpayers, it would be quite challenging in practice to trace the transaction over the past eight months and revise the relevant tax calculation and withholding tax slips to adopt this clause.

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